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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D., 1940.

No. 291.

EQUITABLE LIFE INSURANCE COMPANY OF IOWA,
Petitioner,

vs.

HALSEY, STUART & CO., A Corporation, *Respondent.*

BRIEF OF PETITIONER.

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SUMMARY OF ARGUMENT.

The representations made by respondent to petitioner were made in Iowa, and the contract for the purchase of the bonds was there consummated. This case, and the rights and liabilities of the parties, are, therefore, to be determined by the law of Iowa 19

I.

The so-called "hedge clause" of the offering circular, "all statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security," does not relieve respondent from liability for misrepresentations, falsely or recklessly made 19, 23

A.

Respondent adopted the representations contained in the rotogravure magazine, the Chamber of Commerce booklets, and the magazine advertisements, by delivering them to petitioner in response to a request for more information than contained in the offering circular. The "hedge clause" may not be construed to relieve respondent from responsibility for such statements 19, 24

B.

Since respondent in fact purchased the local improvement bonds solely in reliance upon the Lumber Company's guarantee, and paid no attention to the assessments upon Longview real estate, the statement in the "hedge clause" that respondent had relied upon the facts therein stated in the purchase of the securities, was essentially misleading, and constituted a false and fraudulent representation, and presents no defense to a charge of fraud 20, 25

C.

The record presents a question for the jury as to respondent's liability for fraud, based upon statements recklessly made, without knowledge as to their truth or falsity 20, 28

II.

II.

The Seventh Circuit Court of Appeals overlooked, misconstrued or disregarded the evidence disclosed by the record, which justified a finding by the jury that respondent well knew the falsity of the statements in the offering circular, and other exhibits, as to the frontage of the city upon the Columbia River, and the location of the Long-Bell, Weyerhaeuser and Longview Fibre plants outside the limits of the city 20, 32

III.

Respondent was not merely silent with respect to the financial condition of the Lumber Company, guarantor of the bonds, but indulged in half-truths, made affirmative statements and representations, misleading in character, and by suppressing the true facts, created a false and fraudulent impression as to the financial stability of the Lumber Company. The conclusion of the Circuit Court of Appeals that respondent was under no duty to disclose the true facts, is contrary to established rules of law 21, 38

A.

Where positive representations are made, which are true when made, but pending the transaction conditions substantially change, to the knowledge of the party making the original representations, good faith and common honesty require that the party making such representations advise the other of the change which has taken place, and failure to do so constitutes actionable fraud 21, 52

IV.

The rule of caveat emptor has no application to business transactions concerning the credit and financial standing of third persons. Even where one is under no obligation to supply information as to the credit standing of a third person, if he undertakes to do so, and leads the other party to believe that the credit of such third person is different from the facts within his knowledge, and fails to disclose information vitally affecting the credit of such third person, he is liable for fraud 22, 54

V.

The conclusion of the court, that the letter of May 14, 1930, stating

"We believe you have before you practically all the data covering this issue of bonds," and

"You observe, of course, that this city has no funded debt other than these improvement bonds,"

was of "trivial materiality," substitutes the judgment of the Circuit Court of Appeals for that of the jury, on the weight of the evidence 22, 59

VI.

That petitioner might have learned the true facts with respect to the location of the industrial mill properties at Longview, by independent investigation, or could have learned of the trend of the Lumber Company's earnings from other sources, constitutes no defense to charges of fraud. The Iowa law (which governs this case) is that mere negligence of a defrauded vendee can never be pleaded as a defense to a charge of fraud by a vendor 23, 63

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BRIEF OF PETITIONER.

The Opinion Below.

The opinion of the Circuit Court of Appeals for the Seventh Circuit in this cause is reported as "*Equitable Life Insurance Company of Iowa v. Halsey, Stuart & Co.*, 112 Fed. (2d) 302." It appears in full at R. 657-673 inc.

Jurisdiction.

The jurisdiction of this court to review the judgment of the United States Circuit Court of Appeals, for the Seventh Circuit, is expressly provided for by Judicial Code, Sec. 240, as amended by the Act of February 13, 1925. Petitioner brought this action in the Northern Illinois District, for damages of $250,157, based upon fraud in the sale of bonds of

local improvement districts of the City of Longview, Washington.

The district court submitted the cause to the jury, which returned a verdict of $66,150, for petitioner, upon which judgment was entered. This judgment was reversed by the Circuit Court of Appeals for the Seventh Circuit, which held that the trial court should have directed a verdict for respondent. This court granted certiorari October 14, 1940.

Statement of the Case.

Petitioner, an Iowa life insurance company, instituted this action in the Northern Illinois District against respondent, an Illinois corporation, dealing in bonds and securities. Respondent, known to petitioner, and its officers, as one of the nation's leading bond and investment houses, about May 1, 1930, offered petitioner, as an investment for its policy reserves, a large block of Longview, Washington, local improvement district bonds. Respondent was represented in this transaction by its salesman Kelley. (R. 169) Kelley first delivered to F. W. Hubbell, petitioner's vice president and treasurer, an offering circular, Exhibit "B-1," describing the bonds. (R. 171, 296) Exhibit "B-1" is reproduced at R. 410-413. This circular described the bonds as payable from the proceeds of special assessments levied upon benefited properties, and guaranteed by Long-Bell Lumber Company. It contained the following statement:

> "Longview is situated about 133 miles south of Seattle at the confluence of the Columbia and Cowlitz Rivers. It has a frontage of 7¼ miles on the former, and is a port of call for ocean-going vessels midway between Portland and the Pacific Ocean. * * * Because of its natural advantages and proximity to the timber stands of the Long-Bell and Weyerhaeuser interests, Longview was selected as the site for the vast lumber manufacturing plants of these companies. The present output of the Long-Bell plants is 1,800,000 board feet per

day. The Weyerhaeuser plants are under construction. Manufacturing plants have also been erected by other concerns, including the Longview Concrete Pipe Company, the Pacific Straw Paper & Board Company, the Magor Car Corporation, the Standard Oil Company, Longview Paint & Varnish Company, and the Central Mill Works. The first unit of the plants of the Longview Fibre Company, to cost two and one-half million dollars, is now well under way."

The circular contained the following notation in fine print:

> "All statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we ourselves have relied upon them in the purchase of this security." (R. 413)

Kelley stated to Hubbell that these bonds were secured by assessments on properties in the City of Longview, Washington, and as additional security, carried the full and complete guaranty of Long-Bell Lumber Company. (R. 170-171) Kelley also stated that Long-Bell Lumber Company was a very large, long-established company, doing business partly in the south and partly in the west. (R. 173, 187)

After reading the circular, Hubbell asked Kelley for more information about the City of Longview, what the property was out there, and about the Long-Bell Lumber Company. (R. 187-188) In response to such request, Kelley secured from respondent's Chicago office, and delivered to Hubbell, Exhibits "B-23" and "B-25" to "B-34," inc. (R. 171) Exhibit "B-23" was a tabulation showing the amounts of bonds originally issued in each of the various improvement districts, the number of bonds previously called and redeemed, and the number outstanding. (R. 171; reproduced R. 465) Exhibit "B-25" is not reproduced in the Record, but will be found in the exhibits certified to this court. It is a rotogravure booklet of magazine size, issued by the Longview

Company, a Long-Bell Lumber Company subsidiary, and profusely illustrated with photographs of Longview. On the back of this exhibit is a map which shows the location of the Long-Bell Lumber Company mills, the property of the Weyerhaeuser Timber Company, and the City of Longview, extending along the northerly side of the Columbia River. The corporate limits of the city are not shown. The map bears a legend reciting that it

> "is intended to show in a general way the relation of the various parts of the city site to each other, and location of the city in relation to water, railroad and highway transportation facilities."

Plaintiff's Exhibit "B-27" (which has also been certified to this court) was a reprint of an advertisement published in the Saturday Evening Post. It contained an illustration of extensive manufacturing plants, beneath which appeared the following statement:

> "The thoroughly modern, electrically operated manufacturing plants shown in the above sketch are in Longview, Wn. They produce 1,800,000 feet of Douglas fir lumber a day. The buildings cover 72 acres."

Exhibit "B-28" (likewise certified to this court) is a descriptive booklet, issued by the Longview Chamber of Commerce, profusely illustrated. This booklet stated:

> "Because Longview has proven by thorough investigation to offer those essentials necessary for successful industry, great manufacturing enterprises have made, and are making investments in this new industrial city. Appreciation of the many facilities of the site first led the Long-Bell Lumber Company to select it for the greatest lumber manufacturing plants in the world. The Weyerhaeuser Timber Company, largest lumber concern in the United States, has within the past two years built and put into operation a plant of three great mills on a 700 acre site on the Longview water front."

From the offering circular, and other exhibits, Hubbell understood that the industrial plants referred to were inside the corporate limits, and subject to assessment in those improvement districts embracing substantially the whole city. (R. 172) Kelley informed Hubbell that the limits of local improvement districts, Nos. 19 and 11, were practically co-extensive with the limits of the city. (R. 174) On May 15, 1930, Hubbell received a letter from Frank A. Wood, respondent's Chicago sales manager, identified as plaintiff's Exhibit "B-24". (R. 172; reproduced R. 466) In this letter respondent offered petitioner $100,000 par value of the Longview local improvement district bonds in exchange for a like amount of State of Louisiana highway bonds, maturing in March, 1931, then owned by petitioner. $85,000 of such bonds were to be immediately delivered, and $15,000 for delayed delivery. The letter concluded:

> "We believe you have before you practically all the data covering this issue of bonds, but if you have any questions in mind, we shall be pleased, indeed, to have you call Mr. Kelley or this office for anything you may need.
>
> You observe, of course, that this city has no funded debt other than these improvement bonds, and that the original debt has been materially reduced through retirement and maturity."

The Long-Bell, Weyerhaeuser, Longview Fibre and Standard Oil Company plants were all outside the limits of Longview, and none of those properties were subject to assessment in any of the improvement districts. (R. 212) The mill properties were located between the Columbia River and the limits of the City of Longview. The city never had a frontage of 7¼ miles upon the Columbia River, and in fact no frontage at all, except for a very short distance adjacent to the Port of Longview dock. (R. 212) Substantially every lot and parcel of land included within the

local improvement districts of Longview was also included within a diking district known as Cowlitz County Consolidated Diking District No. 1. (R. 264) In May, 1930, there were outstanding $2,554,000 of Consolidated Diking District Bonds, payable from the proceeds of special assessments levied upon all lands within the district. (R. 264, 265) Respondent well knew of the outstanding diking district bonds, for it had purchased from the Long-Bell Lumber Company, and resold the entire Consolidated Diking District Bond issue in 1925. (R. 76-77)

Kelley also delivered to petitioner, Exhibit "B-34," a consolidated balance sheet of Long-Bell Lumber Company and its subsidiaries, as of December 31, 1929. (Reproduced R. 467-478, inc.) This balance sheet disclosed total assets of $116,183,706, of which current assets, comprising cash and inventories, amounted to $15,831,180. Current liabilities were $7,795,940, including bank loans of $4,000,000. The funded debt of the corporation and all subsidiaries was $41,-794,042, and capital and surplus were shown in excess of $59,000,000.

R. E. Simond, a vice president of respondent, testified, when called as an adverse witness, under rule 43-B, that in purchasing the local improvement district bonds, respondent gave no consideration to the special assessments against Longview real estate; that respondent regarded the Long-Bell Lumber Company's guarantee as the sole justification for handling the bonds, (R. 74, 81), and that respondent would not have handled the bonds at all without such guarantee. (R. 82) Respondent knew that the assessed valuations of lands within the various improvement districts in 1925, and subsequent years, were very low. (R. 80) These facts were never communicated to petitioner. (R. 315)

On May 17, 1930, petitioner purchased $85,000 of Longview local improvement bonds, exchanging a like amount of State of Louisiana Highway Bonds, which then had a market

value slightly above par. On May 26, 1930, it exchanged $15,000 of Louisiana Highway Bonds for a like amount of the Longview improvement bonds.

On June 4, 1930, Wood, respondent's Chicago sales manager, again wrote petitioner, stating that it was rumored that Long-Bell's subsidiary railroad might be purchased by certain trunk line railroads operating in the Pacific Northwest. (R. 483) With respect to this, Wood said:

> "This rather emphasizes not only the importance of this particular asset of the Long-Bell Lumber Company, but also the importance of Longview, Washington, itself. Regardless of whether this does or does not take place, the reflection on Longview, Washington, cannot be other than favorable.
>
> Incidentally, I think you might be interested in knowing that within the past few days they have undertaken the retirement of a very substantial amount of Long-Bell Lumber Company mortgage bonds from funds which became available from the sale of capital assets not necessary to the successful operation of the Company."

Subsequent purchases of the Longview improvement bonds were made by petitioner, as follows:

September 29, 1930—	$26,000	par value, for cash, at 99 3/4.
October 10, 1930—	$ 9,000	par value, for cash, at 99 3/4.
October 21, 1930—	$200,000	par value, in exchange for City of Chicago Tax Anticipation Warrants having a value slightly above par.
October 30, 1930—	$ 2,000	par value, for cash, at 99 3/4.

In all, petitioner purchased $353,000 par value of Longview local improvement bonds from respondent. (Exhibit "B-35," R. 479) Of these, $219,000 were bonds of District 11,

and $60,000 were bonds of District 19, which were the two districts which embraced the whole City of Longview. (R. 479) All negotiations for the purchase of these bonds were conducted at petitioner's office in Des Moines, Iowa, approximately two thousand miles distant from Longview, Washington. Petitioner made no independent investigation of the bonds before purchasing them. (R. 172)

A very close business relationship existed between the Long-Bell Lumber Company and respondent in the years immediately preceding 1930. Between 1922 and 1926, respondent purchased from the Lumber Company, and resold, more than $25,000,000 of First Mortgage Bonds, secured by liens upon standing timber, manufacturing plants and mill properties, including those located just outside the corporate limits of Longview. (R. 115) In 1925, respondent purchased from the Lumber Company, and resold, Cowlitz County Consolidated Diking District Bonds, guaranteed by the Lumber Company, in the amount of $3,260,000. (R. 78) In 1926, respondent purchased from the Lumber Company, and resold, $3,250,000 of Collateral Gold Notes, secured by all of the outstanding bonds of a railroad subsidiary. (R. 116) In the offering circular of that issue, respondent was referred to as the "fiscal agent" for the Lumber Company. (R. 425) Respondent also purchased from the Lumber Company, and resold, more than $3,000,000 of Longview local improvement district bonds in the years 1925, 1926 and 1927.

The Lumber Company kept respondent very closely advised of developments at Longview. F. K. Shrader, respondent's vice president, testified that respondent received reports of the Lumber Company's real estate activities in Longview, at more or less regular intervals, and that the Lumber Company intended to keep respondent posted with respect to real estate sales. (R. 157) Exhibit "P-50" is a report made by the Longview Company, one of the Lumber

Company's subsidiaries, to Mr. R. A. Long, its Chairman, at the 1927 year end, and discloses the activities of the real estate sales department at Longview. That report was found in the files of Halsey, Stuart & Co. Respondent likewise had in its file, Exhibit "P-51," which was a similar report covering the activities of the Longview real estate sales department, for the month of May, 1928, and Shrader, in response to a *duces tecum* subp produced Exhibit "B-18," a similar real estate sales repo r April, 1928. (R. 158) Exhibits "B-18," "P-50" and "P-51" are not reproduced in the record, but will be found among the exhibits certified to this court. Exhibit "P-50" discloses that during the year 1927 sales of Longview real estate by the Lumber Company's subsidiary had practically ceased. During the months of April and May, 1928, as disclosed by Exhibits "P-51" and "B-18," properties were being taken back on the forfeiture of installment sales contracts, so rapidly that, in each of those months, forfeitures and re-purchases, in number, and valuations of properties, equalled new sales. (R. 158, 159, 222-227)

In November, 1927, respondent received advance notice that the Lumber Company's directors would omit the quarterly dividend on the Class "A" stock of the holding corporation, which controlled the Lumber Company. (R. 155) In 1928, respondent conducted market operations in securities of the Lumber Company, and asked $75,000 as compensation for bringing about an improvement in the market value of the Lumber Company's bonds. (R. 88, 89, and see Exhibit "B-5," reproduced at R. 431)

In January, 1930, the Lumber Company's executives conferred with respondent with respect to a proposed merger of lumber producers in the Pacific Northwest. (R. 91, 92) See plaintiff's Exhibit "B-6," reproduced at R. 433-435, in which it was stated by the Lumber Company's officers:

"It is recognized that if the lumber industry of the Pacific Northwest is to be placed on a permanently stable and profitable basis, the desired economies effected and waste reduced, something more than the present individual and desultory attempts to regulate production, which regulation at best is only a temporary expedient to meet quickly an acute and distressing situation, must be accomplished."

In connection with its purchases of various Lumber Company's securities, respondent sent three of its vice presidents, F. K. Shrader, C. T. MacNeille and Walter I. Sleep, to Longview. (R. 116, 153) Sleep, vice president in charge of municipal securities, was in Longview when the contract for the purchase of the first Longview improvement issues was entered into. (R. 211, 212, and See Exhibit "P-34," reproduced R. 513-515, inc.) Sleep died before the trial. (R. 72) Shrader and MacNeille testified as witnesses, but neither denied knowledge that the mill properties of the Lumber Company and the Weyerhaeuser timber mills were outside the corporate limits of Longview.

During the early months of 1930, respondent was informed that the Lumber Company was endeavoring to sell its railroad subsidiary near Longview to certain trunk line railroads operating in the Pacific Northwest; that the Lumber Company was endeavoring to procure a large loan on another line of railroad at Weed, California, and to dispose of its power generating plant located adjacent to Longview, which supplied power for lighting and domestic uses in the City of Longview. (R. 142) The purpose of disposing of these properties was "to strengthen the Lumber Company's current financial position, by converting physical assets into working capital, to meet current requirements." (R. 142) Respondent was told of the Lumber Company's efforts in that direction. (R. 142)

In March and April, 1930, the Lumber Company executives applied to respondent to market a bond issue for $150,-

000, to be secured by a mortgage on the properties of the Longview Daily News, a daily newspaper at Longview, owned or controlled by the Lumber Company, and to underwrite an issue of notes to be secured by pledge of payments coming due under installment sales contracts for standing timber, which the Lumber Company had sold to others. (R. 92) On April 14, 1930, respondent's president, H. L. Stuart, advised the chairman of the Lumber Company, that

> "Long-Bell credit is selling in the market on such a basis as to make it difficult, if not too costly, to undertake the sale of notes secured by the pledge of participation certificates." (R. 93)

On May 5, 1930, Stuart suggested to Long, Chairman of the Lumber Company, that he apply to the New York banking houses of Lehman Brothers Corporation, and Goldman-Sachs, for the desired financing for the Lumber Company, stating that they

> "might be induced to make loans where the securities were not immediately marketable, but that they would probably demand a large commission or bonus." (R. 93, 94)

In that same letter Stuart stated:

> "I have not been able to see any daylight yet on just how the object can be accomplished, so far as getting a security which would be salable to the public is concerned." (R. 94)

On May 15, 1930, Long, Chairman of the Lumber Company, wrote Stuart that he had been unable to secure the desired financing in New York. (R. 94, 95) In that letter Long stated to Stuart:

> "At the present, with business conditions as they are, we also need to strengthen our current position. If this could be done to an extent by accomplishing a disposition of the timber contracts, the importance of such a

transaction is emphasized. Especially so, since we find the commercial bankers in a generally critical and sensitive attitude of mind. We, therefore, have the problem before us of meeting this situation, and doing everything possible to improve it so far as our position is concerned." (R. 94, 95)

The matter of additional financing for the Lumber Company was repeatedly brought up by its executives with respondent until sometime in June, 1930. (R. 163, 164) On June 2, 1930, Shrader, respondent's vice president, wrote the Lumber Company Chairman that difficulties in the way of marketing any securities which "have anything to do with lumber, are so great as to make it almost impossible." (R. 165)

About May 5, 1930, the Lumber Company's executives made a trip to New York City, and were there advised by the officers of the Chase National Bank of New York, that the Lumber Company's line of credit would not be renewed unless its current financial position could be strengthened. The Chase Bank suggested that a new subsidiary corporation be created which would own all liquid assets of the Lumber Company, and conduct borrowing operations with commercial banks. (R. 129, 130) These suggestions were discussed with Stuart, respondent's president, in the spring or summer of 1930. (R. 130, 148) Stuart commented that if the Lumber Company found it could carry commercial bank loans only by having a separate subsidiary, that was probably the thing to do. (R. 148, 149)

On June 30, 1930, Stuart wrote the Lumber Company Chairman, stating in part:

> "Perhaps your banks, except for Mr. Lonsdale's, had behaved themselves very well. (R. 441) * * * I am sure that Mr. Andrews gave you my message, which was to ask you to kindly let me know the outcome of your next talk with the Chase Bank." (R. 442, 105)

Mr. Andrews was the General Counsel of the Lumber Company and the Mr. Lonsdale referred to was the head of a large St. Louis bank, which had refused to renew the Lumber Company's line of credit. (R. 105, 348) In October, 1930, the Lumber Company created a new subsidiary corporation, called "Long-Bell Lumber Sales Corporation," to which it conveyed, as of November 1, 1930, practically all of its liquid and unencumbered properties, its retail sales yards, and most of its cash. (R. 132) The Sales Corporation leased the Lumber Company's mills and manufacturing plants, took over substantially all its personnel, and became the active company in dealing with the public, insofar as the manufacture and sale of lumber was concerned. (R. 133) The Lumber Company retained its encumbered properties. (R. 133)

In June, 1934, the Lumber Company filed a petition for reorganization, under Section 77-B of the Bankruptcy Act, in the United States District Court, for the Western District of Missouri. (R. 134) By the terms of the decree of that court in the reorganization proceeding, the Lumber Company was relieved of its guarantee of the Longview local improvement district bonds, and petitioner received in lieu of such guarantee, 8.4 shares of common stock in the reorganized corporation for each $1,000 Longview local improvement district bond. (See Exhibit "B-53," not reproduced in the Record, but certified to this court.) This stock had a market value per share in December, 1935, of approximately $10—$8 bid, $12 asked. (R. 139) The Lumber Company defaulted in payment of the local improvement assessments upon practically all of the unimproved lots and lands in the various local improvement districts in 1931, and also in the payment of general taxes upon its unimproved properties. Cowlitz County, Washington foreclosed its liens for general taxes of 1931 in 1937, and received a tax deed in 1938, which completely wiped out the

lien of the local improvement assessments. (R. 266-267)

Petitioner first learned of the falsity of the representations with respect to the location of the mill properties in June, 1931, when its representative, James H. Windsor, made a one day trip to Longview. (R. 183) In August, 1931, petitioner first learned that the diking assessments were liens upon the lots and lands within the City. (R. 183) Petitioner's vice president and treasurer made a trip to Longview in the summer of 1934. (R. 184) Petitioner learned in April, 1931, facts regarding the organization of the Long-Bell Lumber Sales Corporation, and that the Lumber Company had borrowed $1,000,000 from the Southern Pacific Railroad Company. Petitioner made complaint to respondent's salesman Kelley in the summer, or fall of 1931, that it had been imposed upon in the transaction. (R. 201, 209)

The complaint in this cause was filed April 10, 1935, and after certain preliminary motions, an amended and supplemental complaint was filed, in which petitioner charged respondent with fraud in the following particulars:

A. That respondent falsely represented that the large and extensive mill properties of the Lumber Company, Weyerhaeuser Timber Company and Longview Fibre Company and others, were all in Longview, and subject to assessment in local improvement districts Nos. 11 and 19, the limits of which were substantially co-extensive with the limits of the city itself.

B. That Longview had a frontage of seven and one-quarter miles upon the Columbia River, (which fact, if true, would bring the mill properties within the corporate limits) while in truth and in fact, said city had no frontage upon the Columbia River.

C. That respondent represented that the bonds were the only bonds constituting a charge or lien upon the lands in the improvement districts of the city, while in truth and

in fact, as respondent well knew, substantially every lot and parcel of land within the city was subject to the lien of large and burdensome assessments levied in the diking district.

D. That respondent, by making false and misleading representations as to the financial strength of the Lumber Company, guarantor of the bonds, and at the same time concealing and failing to disclose that the Lumber Company was in fact in precarious financial condition, misled and deceived petitioner as to the true financial condition of the Lumber Company.

Respondent's answer admitted its corporate capacity, the nature of its business and the sales of the bonds to petitioner; admitted knowledge that the major portion of all real estate in Longview was subject to assessment in the diking district; admitted that the bonds of the diking district were purchased by respondent from the Lumber Company and resold to its customers in 1925; admitted the writing of the Wood letter of May 14, 1930, Exhibit "B-24," but denied the effect of same; admitted that the offering circular contained the statements and representations charged, but alleged that it merely purported "to give a general description of the commercial activities and possibilities of the Longview community;" denied that respondent led petitioner to believe that it had furnished full, complete and accurate information as to the City of Longview; denied that it made representations to petitioner concerning the financial condition of the Lumber Company, but admitted the delivery of the January 1, 1930, balance sheet and financial statement; denied that respondent fraudulently concealed the true financial condition of the Lumber Company; admitted the formation of the Long-Bell Lumber Sales Corporation, but denied knowledge thereof at the times of the sales of the improvement bonds to petitioner; denied all allegations of damage.

The district court submitted the case to the jury, which returned a verdict for petitioner in the sum of $66,150, upon which judgment was entered. (R. 625)

The Circuit Court of Appeals for the Seventh Circuit reversed the judgment on the sole ground that the evidence was insufficient to justify a finding of actionable fraud. That court held that, although the representations as to the industrial plants, and the frontage of the City of Longview upon the Columbia River, were false and misleading, the evidence was insufficient to justify a finding that respondent knew their falsity; that since these representations, while contained in exhibits submitted to petitioner in response to a request for more information than was disclosed by the original offering circular, plaintiff's Exhibit "B-1," were substantially the same as those set forth in that exhibit, the so-called "hedge clause" of the circular relieved respondent from liability for such misstatements. That court likewise held that the statements of the Wood letter that "The city has no funded debt other than these improvement bonds," and "You have before you practically all the data," while carelessly made, were of "trivial materiality" because the Lumber Company's balance sheet disclosed that the Lumber Company had guaranteed diking bonds, the location of which was not shown, and petitioner was not misled, because Hubbell testified, on cross examination, that it was not his general custom, in 1930, in purchasing municipal securities, to investigate the extent of bonds issued by overlapping municipal sub-divisions. The appeals court said that respondent's failure to disclose that it had handled the bonds solely in reliance upon the Lumber Company's guarantee of payment, and would not have dealt with them at all, but for such guarantee, presented a more perplexing question, but that as the parties were dealing at arm's length, there was no duty upon respondent to make such disclosure. With respect to the charge of fraud in conceal-

ing the true financial condition of the Lumber Company, the appeals court said that the evidence presented only a failure to disclose facts, not amounting to fraud, and, petitioner could, by proper investigation, have ascertained the true facts, and for these reasons the district court should have withdrawn the case from the jury. (See opinion of the court below, R. 657-673)

Specification of Errors Relied Upon for Reversal.

(1) The Circuit Court of Appeals for the Seventh Circuit erred in holding that the "hedge clause" of the offering circular,

> "All statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security,"

relieved respondent from liability for statements falsely made, or recklessly made, by means other than the offering circular itself, particularly in view of the admission, by respondent, that it dealt in the securities, not in reliance upon facts therein stated, but solely because the bonds were guaranteed by the Long-Bell Lumber Company.

(2) The Circuit Court of Appeals for the Seventh Circuit erred in holding the evidence insufficient to support a finding that respondent knew of the falsity of the statements contained in the offering circular, and other exhibits, as to the location of the mill properties, and the frontage of the city upon the Columbia River.

(3) The Circuit Court of Appeals for the Seventh Circuit erred in holding respondent free from fraud under the record, which showed that respondent in writing represented that petitioner had received "practically all the data covering this issue," and by the letter of June 4, (Exhibit "B-40," R. 483) was told of the financial strength of the

Lumber Company, while respondent withheld facts within its knowledge which showed the guarantor corporation was financially embarrassed, and about to transfer all its liquid and unencumbered properties to a new subsidiary corporation, for the express purpose of placing its commercial bank creditors in preferred position.

(4) The Circuit Court of Appeals for the Seventh Circuit erred in holding respondent free from actionable fraud under the record, which disclosed that respondent, after furnishing a balance sheet and financial statement showing a relatively sound financial condition of the guarantor, solicited purchases of additional bonds of the same issue, without disclosing that the guarantor was about to organize a new subsidiary corporation, to which it expected to transfer all its cash and unencumbered properties.

(5) The Circuit Court of Appeals for the Seventh Circuit substituted its judgment for that of the jury below, in holding that the statements of the Wood letter,

> "We believe you have before you practically all the data covering this issue of bonds," and
> "You observe, of course, that (the municipality) has no funded debt other than these improvement bonds,"

were of "trivial materiality." The record establishes without dispute that respondent withheld from petitioner material information as to the existence of the outstanding diking bonds, and the diking assessment liens, which were superior to the local improvement assessments, and also respondent withheld material information in its possession disclosing the true financial condition of the guarantor.

(6) The Circuit Court of Appeals for the Seventh Circuit erred as a matter of law, in holding that respondent's failure to make independent investigation concerning the local improvement district bonds constituted a defense to the charges of fraud.

(7) The Circuit Court of Appeals for the Seventh Circuit erred, as a matter of law, in holding the evidence insufficient to justify submission of the issues of respondent's fraud to the jury.

SUMMARY OF ARGUMENT.

The representations made by respondent to petitioner were made in Iowa, and the contract for the purchase of the bonds was there consummated. This case, and the rights and liabilities of the parties, are, therefore, to be determined by the law of Iowa.

Beale, Conflict of Laws, pg. 1288, Sec. 378.1; Sec. 378.2, pg. 1289; Sec. 412.2, pg. 1333.
Redfern v. Redfern, 212 Iowa 454, 236 N. W. 399.
Erie Railroad Co. v. Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188.

I.

The so-called "hedge clause" of the offering circular, "all statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security," does not relieve respondent from liability for misrepresentations, falsely or recklessly made.

Jordan v. Nelson, 178 N. W. 544, 10 A. L. R. 1464 (Iowa, not officially reported).
Bridger v. Goldsmith, 143 N. Y. 424, 38 N. E. 458.
23 American Jurisprudence, pg. 778, Subject—Fraud and Deceit, paragraph 26.

A.

Respondent adopted the representations contained in the rotogravure magazine, the Chamber of Commerce booklets, and the magazine advertisements, by delivering them to petitioner in response to a request for more information

than contained in the offering circular. The "hedge clause" may not be construed to relieve respondent from responsibility for such statements.

B.

Since respondent in fact purchased the local improvement bonds solely in reliance upon the Lumber Company's guarantee, and paid no attention to the assessments upon Longview real estate, the statement in the "hedge clause" that respondent had relied upon the facts therein stated in the purchase of the securities, was essentially misleading, and constituted a false and fraudulent representation, and presents no defense to a charge of fraud.

C.

The record presents a question for the jury as to respondent's liability for fraud, based upon statements recklessly made, without knowledge as to their truth or falsity.

Hanson v. Kline, 136 Iowa 101, 113 N. W. 504.
Davis v. Central Land Co., 162 Iowa 269, 143 N. W. 1073.
Haigh v. White Way Laundry Co., 164 Iowa 143, 145 N. W. 473.
Ultramares Corporation v. Touche, Niven & Co., 255 N. Y. 170, 174 N. E. 441, 74 A. L. R. 1139.

II.

The Seventh Circuit Court of Appeals overlooked, misconstrued or disregarded the evidence disclosed by the record, which justified a finding by the jury that respondent well knew the falsity of the statements in the offering circular, and other exhibits, as to the frontage of the city upon the Columbia River, and the location of the Long-Bell, Weyerhaeuser and Longview Fibre plants outside the limits of the city.

III.

Respondent was not merely silent with respect to the financial condition of the Lumber Company, guarantor of the bonds, but indulged in half-truths, made affirmative statements and representations, misleading in character, and by suppressing the true facts, created a false and fraudulent impression as to the financial stability of the Lumber Company. The conclusion of the Circuit Court of Appeals that respondent was under no duty to disclose the true facts, is contrary to established rules of law.

23 American Jurisprudence, Fraud and Deceit, Paragraphs 93 and 94.
Noble v. Renner, 177 Iowa 509, 159 N. W. 214.
Foreman v. Dugan, 205 Iowa 929, 218 N. W. 912.
Cable v. United States' Life Insurance Co., 111 Fed. 19.
Laidlaw, et al. v. Organ, 2 Wheaton 178, 4 L. Ed. 214.
Stewart v. Wyoming Cattle Ranche Co., 128 U. S. 383, 32 L. Ed. 439.
Tyler v. Savage, 143 U. S. 79, 36 L. Ed. 82.
Downey v. Finucane, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. (N. S.) 307.
MacDonald v. DeFremery, 142 Pac. 73 (Calif.).
MacDonald v. Roeth, 176 Pac. 38 (Calif.).
Crompton v. Beedle, 83 Vt. 287, 75 Atl. 331.

A.

Where positive representations are made, which are true when made, but pending the transaction conditions substantially change, to the knowledge of the party making the original representations, good faith and common honesty require that the party making such representations advise the other of the change which has taken place, and failure to do so constitutes actionable fraud.

Noble v. Renner, 177 Iowa 509, 159 N. W. 214.
Loewer v. Harris, 57 Fed. 368 (C. C. A. 2nd Cir.).

IV.

The rule of caveat emptor has no application to business transactions concerning the credit and financial standing of third persons. Even where one is under no obligation to supply information as to the credit standing of a third person, if he undertakes to do so, and leads the other party to believe that the credit of such third person is different from the facts within his knowledge, and fails to disclose information vitally affecting the credit of such third person, he is liable for fraud.

Foreman v. Dugan, 205 Iowa 929, 218 N. W. 912.
Noble v. Renner, 177 Iowa 509, 159 N. W. 214.
23 American Jurisprudence, Subject—Fraud and Deceit, paragraph 89, pg. 869.
Iasigi, et al. v. Brown, et al., 17 Howard 183, 15 L. Ed. 208.
Thermoid Rubber Company v. Bank of Greenwood, 1 Fed. (2d) 891 (C. C. A. 4th).

V.

The conclusion of the court, that the letter of May 14, 1930, stating

"We believe you have before you practically all the data covering this issue of bonds," and

"You observe, of course, that this city has no funded debt other than these improvement bonds,"

was of "trivial materiality," substitutes the judgment of the Circuit Court of Appeals for that of the jury, on the weight of the evidence.

VI.

That petitioner might have learned the true facts with respect to the location of the industrial mill properties at Longview, by independent investigation, or could have

learned of the trend of the Lumber Company's earnings from other sources, constitutes no defense to charges of fraud. The Iowa law (which governs this case) is that mere negligence of a defrauded vendee can never be pleaded as a defense to a charge of fraud by a vendor.

Ford v. Ott, 186 Iowa 820, 173 N. W. 121.
Creamer v. Stevens, 192 Iowa 920, 185 N. W. 581.
Gardner v. Trenary, 65 Iowa 646, 22 N. W. 912.

ARGUMENT.

I.

The so-called "hedge clause" of the offering circular,

> "All statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security,"

does not relieve respondent from liability for misrepresentations falsely or recklessly made.

The opinion of the court below concedes that the representations of the offering circular, Exhibit "B-1" and other exhibits, that the vast industrial plants of Long-Bell Lumber Company, Weyerhaeuser Timber Company, Longview Fibre Company, and others, were within the City of Longview, (and therefore subject to assessment in Improvement Districts 11 and 19) and that the City had a frontage of seven and one-quarter miles upon the Columbia River, were false and misleading. A reversal of the judgment of the District Court was directed, because, the Circuit Court of Appeals concluded that respondent had "expressly guarded itself against liability for possible inaccuracy by the 'hedge clause' in the prospectus, as set forth above," and, that, since the representations contained in the other exhibits were substantially the same as those contained in the offering circular, the "hedge clause" afforded a defense. This

ruling disregards well-established rules of law, and gives to the "hedge clause" of the offering circular, a wholly unwarranted effect.

The evidence disclosed that Kelley, respondent's salesman, first delivered to Hubbell, petitioner's vice president and treasurer, the offering circular, Exhibit "B-1". After reading this circular, Hubbell requested more information concerning the city, the properties, and the guarantor of the bonds. Kelley procured from respondent's Chicago office, Exhibits "B-24" to "B-34," inc., and delivered them to Hubbell. Kelley also stated that improvement districts Nos. 11 and 19 were practically co-extensive with the City of Longview, itself. The rotogravure booklet, Exhibit "B-25," bore on its back a map, showing the locations of the Long-Bell and Weyerhaeuser holdings, and the Columbia River. The limits of the city were not shown, but it definitely appeared therefrom that if the city had a frontage of seven and one-quarter miles upon the Columbia River, these large and extensive mill properties were within the city.

A few days after these exhibits were delivered, respondent's Chicago sales manager wrote the formal offering letter, which concluded with the assuring words that petitioner had already received "practically all the data covering this issue of bonds," and that the city had "no funded debt, other than these bonds."

A.

Respondent adopted the representations contained in the rotogravure magazine, the Chamber of Commerce booklets, and the magazine advertisements, by delivering them to petitioner in response to a request for more information than appeared in the offering circular.

First, it must be noted that the so-called "hedge clause" appeared only in the offering circular, Exhibit "B-1". There

was no qualification of any kind with respect to the other exhibits. They were delivered by respondent to Hubbell in response to a request for more information than the circular revealed. Respondent gave no indication that it desired to qualify, in any way, the information set forth in the other exhibits, and the recitals of the Wood letter of May 14 clearly indicated that respondent expected Hubbell to rely upon the information which had been furnished. By furnishing these additional exhibits, it seems quite clear that respondent should be held to have adopted the representations therein set forth as its own. It is conceded that these exhibits were delivered for the express purpose of inducing petitioner to purchase the bonds in substantial amounts.

It is well established by the authorities that clauses, by which one attempts to avoid the consequences of false and fraudulent representations, are not favorites of the law, and that notwithstanding such devices liability will be imposed for false and fraudulent representations, whether deliberately false, or recklessly made. The Iowa Supreme Court has laid down this rule in no uncertain terms. In *Jordan v. Nelson,* 178 N. W. 544, 10 A. L. R. 1464, the court held that the inclusion of a provision in a contract reciting that the purchasers of land had inspected the premises on their own behalf, and in making the purchase, and executing the contract, "they are not relying upon any representation made by the first party, and explicitly waive any claim on that account," did not relieve the vendor from responsibility for false and fraudulent representations. The Iowa Supreme Court in that case quoted with approval the language of the Court of Appeals and Errors of New York, in *Bridger v. Goldsmith,* 143 N. Y. 424, 38 N. E. 458, as follows:

> "Public policy and morality are both ignored if such an agreement can be given effect in a court of justice. The maxim that fraud vitiates every transaction would

> no longer be the rule, but the exception. A mere device of the guilty party to a contract, intended to shield himself from the results of his own fraud practiced upon the other party, cannot well be elevated to the dignity and importance of an equitable estoppel."

The rule as to stipulations in a written agreement, which attempt to nullify the effect of fraudulent representations, is well stated in 23 American Jurisprudence, pg. 778, Subject—Fraud and Deceit, paragraph 26, as follows:

> "A provision in a writing that no representations were made to procure the contract, that neither party shall be bound by any representations not contained therein, or that the representee does not rely on representations by the other party, and expressly waives any claim on account thereof, in most jurisdictions does not preclude a charge of fraud, based on oral representations, or proof of what representations were made."

Qualifying statements similar to the "hedge clause" contained in Exhibit "B-1," are sometimes placed upon legal opinions and auditor's reports. In the late case of *Ultramares Corporation v. Touche, Niven & Co.*, 255 N. Y. 170, 174 N. E. 441, 74 A. L. R. 1139, the New York Court of Appeals and Errors held that a statement of this character, placed upon an audit, made by a firm of certified public accountants, would not relieve the firm from responsibility for false or reckless representations as to the scope of the audit.

The holding of the court below, that the "hedge clause" constituted a defense to the misrepresentations contained in the exhibits, other than the offering circular, itself, cites no authority in support of the pronouncement. None was cited in the brief of respondent in the lower court, and we are confident that no such authority exists.

Respondent well knew that the information which it was furnishing was sought by petitioner for the very purpose of determining whether the purchase of a large block of these bonds, as an investment of its policy reserves, was

desirable. The opinion of the court below, that the "hedge clause" of the offering circular afforded a defense to misrepresentations contained in the exhibits, other than the offering circular itself, is quite clearly untenable, and cannot be sustained upon principle or authority.

B.

Since respondent purchased the local improvement bonds solely in reliance upon the Lumber Company's guarantee, and would not have dealt in them at all, except for the guarantee, the statement of the "hedge clause" that respondent had relied upon the facts stated in the circular in the purchase of the securities, was essentially misleading, and constituted a false and fraudulent representation.

The offering circular, Exhibit "B-1," contained the unequivocal statement that "We, ourselves, have relied upon (the facts set forth) in the purchase of this security." R. E. Simond, respondent's vice president in charge of purchases of municipal securities, testified that respondent gave no consideration whatever to the security afforded by the special assessments upon Longview real estate, did not consider the bonds proper for sale to their customers, and would have had nothing to do with the bonds, except for the guarantee of the Lumber Company. (R. 79, 80 and 81) It thus definitely appeared, by this admission of an executive officer of respondent, that the statement of the "hedge clause" that respondent had relied upon the location of the Long-Bell, Weyerhaeuser and Longview Fibre mill properties, the frontage of the City upon the Columbia River, and upon Longview, itself, as an important commercial center, was untrue and misleading.

The "hedge clause," itself, would lead any prospective purchaser of the local improvement bonds to believe that Halsey, Stuart regarded the bonds as worthy investments

on their merits, independent of the Long-Bell guarantee. In this respect, the "hedge clause" itself was a deceptive statement, for respondent did not rely upon the facts set forth in the offering circular in the purchase of the securities. Under such circumstances, it is indeed strange logic to hold, as did the Circuit Court of Appeals, that respondent is relieved from responsibility by the presence of this clause in the offering circular. The "hedge clause," instead of constituting a defense to petitioner's claim, offers affirmative evidence of reckless misstatement by respondent.

C.

Notwithstanding the presence of the "hedge clause," a jury question was presented as to respondent's liability for fraud in making reckless statements and representations, without knowledge as to their truth or falsity.

Respondent well knew that petitioner would rely upon the information contained in the exhibits, other than the offering circular, in purchasing the bonds, and it certainly expected and intended that petitioner would act upon the information therein contained.

The Iowa law, like that of most states, is that under such circumstances, even though one expressly disclaims personal knowledge of a matter, if he attempts to speak concerning the facts, he is liable for false and fraudulent representations, recklessly made, without knowledge as to their truth or falsity. In *Hanson v. Kline*, 136 Iowa 101, 113 N. W. 504, it appeared that plaintiff was the owner of a hardware stock which he desired to exchange for a well-located farm. He was approached by one J. E. Gray, a real estate dealer, who offered a Nebraska farm, in exchange, which was represented as good, level land, in a good neighborhood, with fifty acres under plow, and an additional fifty acres fenced, improved with a small house, a barn,

a well and a windmill. An abstract of title was furnished plaintiff, who took it to W. E. Gray, a lawyer, and the father of J. E. Gray. W. E. Gray told plaintiff that he had never seen the land in question, but that the abstract disclosed that the land had once been mortgaged for $2,000, had been sold some years before for $1,200, and that the land covered by the abstract was a good piece of land, and that plaintiff could rely on the statements made by J. E. Gray as to its quality. W. E. Gray did not act as the attorney for plaintiff, and no fiduciary relationship was present. The evidence showed that the land was wholly unimproved, and of little value, although the abstract of title contained the entries pointed out by W. E. Gray. The trial court submitted the case to the jury, which found against both defendants. The Iowa Supreme Court held that the record warranted submission of the case to the jury, as to the fraud of W. E. Gray, and in the course of its opinion the court said:

> "It is true enough that one who makes a representation respecting existing conditions, and in doing so expressly states that he does not speak from personal knowledge, but is merely repeating information received from others, and he honestly repeats such information, believing it to be true, he cannot be guilty of a fraud. All the authorities are to this effect. But, if he falsely states that he has information when he has none, or if he knows his information is false, or if he intentionally misstates his information, and by the representation he makes he induces another to act to his damage, he may be held guilty of a fraud."

The case of *Davis v. Central Land Co.*, 162 Iowa 269, 143 N. W. 1073, involved a charge of fraud in making representations as to the location of a boundary line between adjoining properties. Plaintiff testified that defendants pointed out a certain line as the boundary between the property purchased and that adjoining it. Defendants de-

nied knowledge of the location of the true boundary line, and denied making the representation. The Iowa Supreme Court said:

> "The fraud alleged consisted in the reckless assertion as true that of which the party knew nothing which was definitely ascertainable, and in deceiving the other party thereby. The principle is well established by the authorities, and the evidence was such as to carry the issue of fraud to the jury."

In the later case of *Haigh v. White Way Laundry Co.*, 164 Iowa 143, 145 N. W. 473, the court considered the sufficiency of the allegations of a petition which charged that a personal injury release had been procured by fraud of the defendant. The Iowa Supreme Court there said:

> "Where a false representation is relied upon as constituting fraud, it must be shown to have been knowingly made, with intent to mislead, or that the party made the statement as true, with no reasonable ground to believe it to be true, for the purpose of inducing the other to act. * * * So, in this case, it is immaterial whether or not the company, by its agent, knew or did not know whether the tendons of plaintiff's hand were in fact injured, for the reason that the defendant, through its agent, asserted it as a fact (and it was a material fact) for the purpose of inducing the plaintiff to believe it was true, and that her injuries were trifling; that she would soon recover. * * * The fraud consists in asserting that to be true which was not true; which the defendant did not know to be true; made with the wrongful purpose and resulting in injury to plaintiff."

In the late case of *Ultramares Corporation v. Touche, Niven & Co.*, 255 N. Y. 170, 174 N. E. 441, 74 A. L. R. 1139, defendants, a firm of certified public accountants, made an exhaustive audit of the affairs of a corporation, and submitted a certificate that their report was

"In accordance with the books, and with the information and explanations given us, and that the balance sheet and financial statement presents a true and correct view of the financial condition of Stern & Co."

The evidence disclosed that $700,000 of accounts receivable listed in the audit and balance sheet were wholly fictitious, and that no check had been made to ascertain whether such accounts were supported by ledger entries, or invoices, for goods sold. The trial court directed a verdict for the defendants, but the New York Court of Appeals and Errors, in an opinion delivered by the late Mr. Justice Cardozo, of this court, reversed the trial court, and held that a jury question was presented as to the fraud of the accountants. The court said

"We conclude, to sum up the situation, that in certifying to the correspondence between balance sheet and accounts the defendants made a statement as true to their own knowledge, when they had, as a jury might find, no knowledge on the subject. If that is so, they may also be found to have acted without information leading to a sincere or genuine belief when they certified to an opinion that the balance sheet faithfully reflected the condition of the business."

No officer or employe of Long-Bell Lumber Company appears to have ever informed respondent, or its officers, that the industrial plants were within the corporate limits of Longview. No executive officer of Halsey, Stuart testified that he actually believed that the extensive mill properties described in the literature concerning the issue were in fact, within the city, and subject to assessment in the city-wide improvement districts. If respondent knew nothing, concerning the location of the mill properties with reference to the corporate limits, or the frontage of the city upon the Columbia River, the statements of the offering circular, and the other literature, were reckless in the extreme, and were such as to bring this case squarely within

the rule of the Iowa decisions from which we have quoted. This phase of the matter seems to have been entirely overlooked in the opinion of the Circuit Court of Appeals.

In the case at bar, respondent well knew that petitioner was considering the purchase of large blocks of the Longview improvement bonds as an investment of its policy reserves. Respondent well knew that petitioner's officers were seeking authoritative information concerning the City of Longview, the properties subject to assessment, and the guarantor corporation. That the information contained in the various pamphlets and circulars submitted, was furnished for the express purpose of inducing the purchase of the bonds, no one denies. Under these circumstances, we submit that even though it be conceded that respondent had no actual knowledge concerning the true location of the Long-Bell, Weyerhaeuser and Longview Fibre Company mill properties, or the frontage of Longview upon the Columbia River, the question of its liability for recklessly making false and misleading statements, was a question for determination by a jury.

II.

The Seventh Circuit Court of Appeals overlooked, misconstrued or disregarded the evidence disclosed by the record, which justified a finding by the jury that respondent well knew the falsity of the statements in the offering circular, and other exhibits, as to the frontage of the city upon the Columbia River, and the location of the Long-Bell, Weyerhaeuser and Longview Fibre plants.

The Circuit Court of Appeals for the Seventh Circuit held that the statements of the offering circular, and the other exhibits, as to the frontage of Longview upon the Columbia River and as to the locations of the mill properties, were false and misleading, but that petitioner's proof

was insufficient to establish that respondent knew the true facts, and that under these circumstances, the so-called "hedge clause" operated to relieve respondent from legal liability. This conclusion could only have been arrived at by overlooking, misconstruing, or disregarding much record testimony, which amply justified a jury in concluding that respondent well knew the true facts as to the frontage of the city upon the Columbia River, and the location of the industrial plants. In fact, a reading of the record conclusively demonstrates that the Circuit Court of Appeals arrived at its conclusion only by substituting its own judgment for that of the jury below, as to the weight to be accorded the undisputed evidence.

For seven or eight years before the purchase of the bonds in question, an unusually close business relationship had existed between Halsey, Stuart & Co. and the Lumber Company. First, Halsey, Stuart & Co. purchased from the Lumber Company, and resold to its customers, three issues of Long-Bell Lumber Company First Mortgage Bonds, amounting in the aggregate to substantially more than $25,000,000. These bonds were secured by first mortgages on tracts of standing timber, and by liens upon various mill properties of the Long-Bell Company, the most important of which were the vast manufacturing properties just outside the limits of Longview. In addition, in 1925, Halsey, Stuart purchased from Long-Bell, and resold to its customers, $3,260,000 of diking bonds, and $3,250,000 of Collateral Gold Notes, secured by the deposit of all of the outstanding bonds of the Lumber Company's subsidiary railroad, as well as several issues of improvement district bonds, amounting in the aggregate to more than $3,000,000, (the issue involved in this litigation).

In connection with the first mortgage financing, respondent sent C. T. MacNeille and F. K. Shrader, its vice presi-

dents, to Longview. S. M. Morris, one of the vice presidents of the Lumber Company, testified, at R. 214,

> "MacNeille was out here two or three times during the early stages of construction. I think he was here in 1922 for the first time. We had attained some degree of development, however, when he was here, for I think he was here after 1924."

F. K. Shrader, another vice president of respondent, testified, at R. 153:

> "I had something to do with issues of bonds known as Series A, B, and C First Mortgage Bonds of the Long-Bell Lumber Company, and I think in connection with that work I went to Longview twice. The first trip I made there, it was practically empty—just the mill site, and a temporary office. The second and last trip was about three years after that. The town was pretty well built up, and the hotel was operating, and it was quite a community."

Both Shrader and MacNeille were witnesses, and testified at considerable length in this case, but it is extremely significant that neither of them denied knowledge as to the location of the corporate limits of the City of Longview, and the mill properties.

Walter I. Sleep, another vice president of respondent, was in charge of the purchases of municipal issues. Sleep made a trip to Longview in May, 1925, and while there, entered into a contract with the Lumber Company for the purchase of the first block of local improvement district bonds acquired by respondent. (See plaintiff's Exhibit "P-34," R. 513, and R. 72) Sleep also acted for respondent in acquiring the diking district bonds. (R. 77) Sleep died before the trial.

The jury then had before it definite evidence that three different vice presidents of Halsey, Stuart & Co. made at least five or six trips to Longview for the express purpose

of investigating the Lumber Company, and the security which it was offering for the various issues of bonds which respondent purchased and offered to its customers. The mill properties were all subject to the lien of the diking district bonds, but none of them were assessed in the local improvement districts. (R. 264) The mill properties of the Long-Bell Lumber Company constituted a very substantial part of the security for the Lumber Company's first mortgage bond issues. The Longview local improvement bonds were handled subsequently. The opinion of the court points out that when petitioner became suspicious and made inquiries concerning the city, and the location of the mill properties, it was able to find out the facts at once, and "there is nothing to suggest why it could not have found them with equal facility before it purchased the bonds." (R. 671)

The record discloses that James H. Windsor, petitioner's representative, in 1931 did learn the true facts as to the location of the mill properties by a one day's visit to Longview. The record discloses that three different vice presidents of respondent made repeated trips to Longview for the very purpose of investigating these various bond issues, yet the Circuit Court of Appeals ruled that petitioner had failed in its proof, because there was no showing that respondent learned facts, which were so open and obvious that petitioner could easily have discovered them, and was chargeable with fault for failure so to do before it purchased the bonds. Apparently the Circuit Court of Appeals saw fit to apply one rule to Halsey, Stuart & Co. and another to the Equitable Life Insurance Company of Iowa.

With these facts before it, was not a jury justified in assuming that MacNeille, Schrader and Sleep made some reasonable degree of investigation concerning issues of bonds which totalled more than $30,000,000 in amount? Would it not be doing violence to both reason and com-

mon sense to assume that these financial experts, investigating issues of bonds which respondent was purchasing and re-offering to its customers as desirable investments, had failed to learn that the Lumber Company's vast mills, which constituted a very vital part of the security for the first mortgage bonds, were outside the limits of Longview, and, therefore, not subject to municipal taxation in the Lumber Company's grandiose scheme of urban development? The jury had a right to take into account the fact that Sleep, respondent's vice president, had traveled from Chicago to Longview for the express purpose of consummating the purchase of the first block of Longview local improvement bonds amounting to one and one-quarter millions of dollars. Is it reasonable to suppose that he would consummate such a transaction without examining a map of the city which was issuing the bonds? Furthermore, vice president Morris, in charge of the Lumber Company's real estate development at Longview, testified that he did not refuse Sleep any information, and that he had never furnished respondent any information indicating that the lumber mills or the Longview Fibre plant were within the City of Longview, or that the City had a frontage of seven and one-quarter miles on the Columbia. (R. 212, 213)

But even these facts do not fully disclose the extent of Halsey, Stuart's actual knowledge of the local situation at Longview. In 1925, through correspondence with Long-Bell's lawyer, located there, R. E. Simond, assistant to vice president Sleep, and his successor, learned the assessed valuations of all the real estate embraced within local improvement districts 1 to 8, inclusive. (R. 80) In 1927, Simond, by correspondence with the Lumber Company's tax agent, Alex Hay, learned that the total assessed valuation of all the property included within the limits of the city, was $3,439,918. (R. 80) The information furnished by the Lumber Company's Longview counsel, disclosed that the

assessed valuation of the property in improvement district No. 1, was $45,220, and that Halsey, Stuart purchased and sold to its customers, $426,815 of improvement bonds of that district.

It is significant, indeed, that no officer of respondent testified that he was informed, or even supposed, that the mill properties were within the city limits of Longview. Vice president Simond says that he did not know what the true facts were, but does not claim that he ever believed that the mill properties were subject to assessment in the city-wide improvement districts. The whole tenor of his evidence is directly contrary to any such belief, for in response to requests from various branch offices for specific information concerning the local improvement bonds, Simond, by his own admission, is shown to have repeatedly informed respondent's salesmen and branch managers, that the valuations of properties embraced within the various districts would probably prove disappointing, and that respondent had relied solely upon the Lumber Company's guarantee in purchasing the bonds. (See R. 79, 80 and 81)

It was not necessary for petitioner, in order to render the question of respondent's knowledge of the location of the limits of the city, and the mill properties, a jury question, to establish by admissions of the executive officers of respondent that they were aware of the location of the industrial plants, or the frontage of the city upon the Columbia River. Neither was petitioner required to establish such fact beyond a reasonable doubt. It was sufficient if petitioner introduced proof from which a jury could properly infer that respondent did have knowledge of the true facts. The courts have long recognized that it is seldom indeed that defendants in fraud cases will admit their knowledge of the falsity of material representations. Guilty knowledge is usually shown, just as in the case at bar, by showing facts and circumstances from which the jury may properly in-

fer that the defendants did possess such knowledge. In view of the fact that the record contains no denial of actual knowledge by Shrader and MacNeille, we submit, that the evidence was sufficient to justify a finding by the jury that respondent did possess knowledge of the true facts. The jury was justified in considering the facility with which the facts became known to petitioner when investigation was made, and might properly conclude that respondent's executive officers could not well have escaped learning the true facts, with reference to the location of the mill properties, and the frontage of the city upon the Columbia River, in their repeated trips to the Longview community. It seems to us very clear that the conclusion of the Circuit Court of Appeals that the evidence was insufficient to show knowledge of the falsity of the statements of the offering circular, usurps the province of the jury, and substitutes the judgment of that court for that of the jury upon the weight of the evidence.

III.

Respondent was not merely silent with respect to the financial condition of the Lumber Company, but indulged in half-truths, made affirmative statements and representations which were misleading in character, and by suppressing the true facts, created a false and fraudulent impression as to the financial stability of the Lumber Company. The conclusion of the Circuit Court of Appeals, that respondent was under no duty to disclose the true facts, is contrary to established rules of law.

After reading the offering circular, Hubbell asked Kelley for additional information concerning the financial situation of the Lumber Company, guarantor of the bonds. In response to this request, Kelley delivered to Hubbell Exhibit "B-34," which was the January 1, 1930 financial report and

balance sheet of the Long-Bell Lumber Company, and its subsidiaries. (R. 467-478) The balance sheet indicated a relatively sound financial condition. Total assets were shown as $116,183,706, and current assets, comprising principally cash and inventories of lumber, were $15,831,180. Current liabilities, including bank loans of $4,000,000, totalled only $7,795,940. Capital and surplus, as disclosed by the balance sheet, were in excess of $59,000,000.

Respondent's officers well knew that this balance sheet presented a misleading picture of the financial condition of the Lumber Company and its subsidiaries. Respondent's officers had been importuned on many occasions between January 1, 1930, and May 15, 1930, to do additional financing for the Lumber Company, and the record demonstrates that in the latter part of March and early April, the Long-Bell executives asked respondent to market a bond issue for $150,000, to be secured by pledge of the assets of the Longview Daily News, a daily newspaper at Longview, owned or controlled by the Lumber Company, or its executives. It was also suggested that respondent underwrite an issue of notes, to be secured by the pledge of payments coming due under installment sales contracts for standing timber, which the Lumber Company had sold to others. (R. 92) On April 14, 1930, respondent's president, H. L. Stuart, wrote the Chairman of the Lumber Company that Long-Bell credit was selling in the market on such a basis as to make it difficult, if not too costly, to undertake a sale of such notes. (R. 93) On May 5, 1930, Stuart had suggested to Long that he approach two New York banking houses, for the necessary financing. In that letter Stuart recognized that the securities of the Lumber Company would not be immediately salable, for he suggested that the New York banking houses might be induced to make loans where the securities could not be immediately marketed, but that they would probably demand a large commission or bonus, (R. 93, 94)

On May 15, 1930, Long advised Stuart that he had been unable to secure the desired financing in New York. (R. 94, 95) On May 15, 1930, Long wrote Stuart of the need to strengthen the Lumber Company's "current position," stating also that he found "commercial bankers in a generally critical and sensitive attitude of mind."

This letter was written after the May 5 meeting of the executives of the Lumber Company with Mr. Place, of the Chase National Bank of New York. At this meeting Mr. Place notified the Lumber Company that its line of credit would not be renewed, unless its current financial position were strengthened, and suggested that this be effected by creating a new subsidiary corporation, which would own all liquid assets of the Lumber Company, and conduct the borrowing operations with banks. (R. 129, 130). This demand, or suggestion, of the Chase National Bank, was discussed with H. L. Stuart, by the Lumber Company officers, in the spring, or summer, of 1930. (R. 130, 148) Stuart, at that time, commented that if the Lumber Company found that it could carry commercial bank loans only by having a separate subsidiary, that was probably the thing to do. On June 30, 1930, Stuart wrote Long a letter, which concluded:

> "I am sure that Mr. Andrews (General Counsel for the Lumber Company) gave you my message, which was to ask you to kindly let me know the outcome of your next talk with the Chase Bank." (R. 442, 105)

We have then this situation disclosed by the record: Respondent had purchased the Longview improvement bonds in 1925, 1926 and 1927, relying solely upon the strength of the guarantee of payment by the Lumber Company. It is conceded that it did not regard the bonds as of worthy investment caliber, except for the guarantee. In May, 1930, it is obvious that respondent's officers fully realized that

the guarantee of the Lumber Company was badly impaired, and of extremely questionable value. It was under these circumstances, that the January 1, 1930, financial statement and balance sheet was furnished to Hubbell, and the letter of May 14, 1930, assuring Hubbell that he had received "practically all the data covering the issue," was written. If there be any question in this record as to respondent's knowledge of the true financial condition of the Lumber Company at any time, it is abundantly established that respondent did have full knowledge of the demands of the commercial banks sometime prior to June 30, 1930, for on that date, Stuart wrote Long asking that he be advised of the result of the next conference of the Lumber Company executives with "the Chase Bank." The Lumber Company appears to have had no other business with the Chase Bank.

On June 4, 1930, after the purchase of the first block of $100,000 of Longview bonds by petitioner, Wood, respondent's Chicago sales manager, wrote Hubbell suggesting that petitioner acquire another $100,000 of the bonds. In this letter he referred to the fact that the Lumber Company was retiring its first mortgage bonds in substantial amounts, from the proceeds of the sale of capital assets, "not necessary to the successful operation of this company." (R. 483)

The Circuit Court of Appeals for the Seventh Circuit disposed of the charges of fraud, based upon the misrepresentations as to the financial condition of the Lumber Company, as involving nothing more than a failure to disclose facts. That court said that there was no duty upon respondent to disclose such facts, and hence, no actionable fraud was shown. In support of its pronouncement, the Circuit Court of Appeals quotes with approval, the text of 23 American Jurisprudence, Fraud and Deceit, paragraph 93, and the Iowa case of *Foreman v. Dugan*, 205 Iowa 929, 218 N. W. 912. The Appeals Court, however, completely overlooked

the fact that respondent was not merely silent with respect to the financial situation of the Lumber Company, but made active representations concerning the financial condition of that company, indulged in half truths, which were essentially misleading, and by assuring petitioner that it had received "practically all the data covering the issue," forestalled independent investigation by petitioner on its own account.

In 23 American Jurisprudence, Fraud and Deceit, which was cited by the Appeals Court in support of its conclusion, the text writer states the rule as follows:

> Par. 93. "Where, in addition to a party's silence, there is any statement, word or act on his part which tends affirmatively to a suppression of the truth, to a covering up or disguising of the truth, or to a withdrawal or distraction of a party's attention from the real facts; then the line is overstepped."

Paragraph 94 of the same work, reads as follows:

> "Very little in addition to non-disclosure of material facts is required to prevent the application of the general rule which renders mere silence non-actionable and to make a party guilty of fraud. For instance, statements ordinarily regarded as expressions of opinion may be considered as sufficient where calculated to mislead and to prevent an examination of the property involved, or to throw the owner off his guard in order to gain the property from him. Indeed, it has been said that the least degree of misrepresentation constitutes very potent evidence of fraud, under such circumstances, and that a single word, a nod, a wink, a shake of the head, or a smile intended to induce the belief in the existence of a non-existing fact, may be sufficient."

Counsel for both parties concede that this case is governed by the Iowa law. The Iowa rule is that fraud is committed whenever one party to a transaction, by half-truths, creates a false and fraudulent impression in the mind of

the other, as to the true facts, and thereby induces him to act.

In *Noble v. Renner*, 177 Iowa 509, 159 N. W. 214, the Iowa court had before it a suit for damages, based on fraud in the sale of a farm immediately adjacent to the east bank of the Missouri River in western Iowa. This farm was subject to the action of the Missouri River, which at flood stage, frequently cuts away large amounts of land by changes in its course. Plaintiff resided in eastern Iowa, and made a trip to the farm on April 17, 1912, and then learned that the farm was subject to the action of the river. He returned to his home in eastern Iowa, and on May 2, 1912, a contract was executed for an exchange of properties. In the meantime, a severe flood had occurred, and the river had changed its course, so as to cut off a substantial portion of the acreage comprised in the farm, and of this fact defendant was advised by a telegram from his agent. It was contended that plaintiff had made his own inspection of the farm, that the parties were dealing at arm's length, and that no obligation was imposed on defendant to advise plaintiff of the action of the stream. The Iowa Supreme Court rejected this contention as untenable, and in the course of its opinion said:

> "It is the theory of appellant that he owed no duty to speak, because this is not a case of the river's cutting, but of continuing to cut as it did when plaintiff saw the land, that both had equal opportunity to learn of this change, and that while in the authorities presented by appellee there was some new element of which one party had knowledge, and which he concealed from the other, in this case there was no element which did not exist from the beginning. He illustrates, one might as well say, there was an actionable misrepresentation because a horse was represented as perfectly sound when inspection made before buying showed the horse had lost a leg.

Is there not more here than a mere case of silence which amounts to a failure to state that which both knew or had equal means of knowing? Is there not affirmative concealment intended to lead another to his injury? Is not appellant proceeding on the lines that he might tenably use if he, too, had been ignorant of what, of necessity, occurred since plaintiff inspected the land? If neither had been advised, and the change had occurred since the inspection, there would be room for saying that defendant had no duty to make sure whether conditions had not changed, and advise plaintiff. But defendant knew not only that plaintiff had made inspection, but that he would naturally rely upon what he found then, and knew that conditions had changed for the worse since then, and that plaintiff did not know it. It is undenied, too, that defendant was not content with mere silence. It appears that on May 2nd, before the contract was signed, defendant told Noble there was no cutting there any more; that there would be a little sluffing of the bank in the spring when the frost was going out. This can have been intended for no other purpose than to strengthen Noble in the belief that conditions remained substantially as they were when he saw the land, and surely tended to do so. And on the morning of May 2nd defendant told plaintiff he would guarantee there were 114 acres, which was again calculated to keep plaintiff in the same misapprehension."

The Iowa rule is also illustrated by the case of *Foreman v. Dugan*, 205 Iowa 929. That case involved a sale of farm lands which were subject to overflow, and lay adjacent to the Des Moines River. There was a drainage ditch which ran through the farm, which plaintiff observed. Plaintiff asked if the farm overflowed, and the defendant replied that it did from ice gorges in the river, which sometimes backed up the water. The Iowa court held that under the particular facts there disclosed, no actionable fraud was shown because the situation was open and obvious to both parties, and each had means of knowledge concerning the true situation. The Iowa court stated the rule in these words:

"Upon this entire record, we are disposed to acquiesce in the conclusion of the trial court that there was not sufficient evidence of false and fraudulent representations on the part of the vendor to carry the case to the jury, or to support a finding of fraud and false representations. It is undoubtedly a correct rule of law that one who is called upon to speak in regard to a subject-matter may be guilty of false representation by evasion, or by speaking half the truth, or failing to speak fully and truthfully where a duty rests upon him to so speak. In other words, one may be guilty, under certain circumstances, of false representations in failing to disclose facts within his knowledge. Silence on a subject may constitute, under certain circumstances, a false representation, quite as much as spoken words. *Howard v. McMillen*, 101 Iowa 453; *Noble v. Runner*, 177 Iowa 509. But, on the other hand, in determining whether there are actionable false and fraudulent representations, consideration must be given to the situation of the parties, the matters with which they are dealing, and the subject-matter in hand. We have here a situation where the topography of the farm and its physical features were perfectly apparent to the appellant, who made a personal examination of the same at the time. He could see the lay of the land. The adjacent river, the near-by hills, and the drainage ditch, were all apparent, visible, and known to him. The minds of the parties, under all of the circumstances surrounding them at the time, were obviously directed to the question of the overflowing of the land from the adjacent river, next to which the lower land of the farm lay. We must construe the representations in the light of the circumstances under which the parties were placed at the time."

The Circuit Court of Appeals cites this decision of the Iowa Supreme Court in support of its conclusion that respondent here was guilty of no fraud with respect to the financial condition of the Lumber Company. But the Circuit Court of Appeals failed to take into account the distinction between the character of the property, with which the Iowa Supreme Court was dealing, and that involved in

the case at bar. The financial situation of the Lumber Company was well known to respondent's officers. Such condition was not something as to which the parties possessed equal knowledge, or means of knowledge. As we shall point out in another division of this brief, the rule of *caveat emptor* has no application to transactions involving the credit, or financial standing, of a third person. There are numerous authorities from this court which demonstrate the wholly untenable character of the rule applied by the Seventh Circuit Court of Appeals.

This is well illustrated by the case of *Tyler v. Savage*, 143 U. S. 79, 36 L. Ed. 82. Mrs. Savage, a woman of considerable means, had a son whom she desired to place in an established business. Tyler was president of a corporation called the Virginia Oil Company, with which the son sought employment. Mrs. Savage suggested that she would be willing to make a substantial loan to the corporation, if her son were given a permanent position. Tyler wrote her, stating that the capital of the company was $18,300; that the last dividend declared was a seven per cent, semi-annual dividend; that the fiscal year ended on June 1; that the company had flattering prospects; that its products were widely distributed, and by adding moderately to its capital, its sales could probably be doubled, with but slight increase in overhead; that thirty shares had recently been purchased at par by a gentleman from New York. Plaintiff invested $10,000 in the stock of the corporation. She later learned that the corporation had paid no dividends for a period of more than one year before the letter was written; that it was largely indebted to Tyler, and was, in fact, in precarious financial condition. It was contended that defendant was guilty of no fraud. This court in disposing of the contention, said:

"Ty er's letter to the plaintiff of April 10, 1884, in saying 'The last dividend that was declared was a 7 per cent semi-annual. The fiscal year ends on the first of June,'—was calculated naturally to produce the impression upon the plaintiff's mind that the last dividend was declared on the 1st of June, 1883, whereas the last dividend was June 1, 1882. It must be inferred that, if the plaintiff had been informed that no dividend had been declared since June 1, 1882, she would not have subscribed for the stock. This suppression of a material fact, which Tyler was bound in good faith to disclose, was equivalent to a false representation. *Stewart v. Wyoming Cattle Ranche Co.*, 128 U. S. 383, 388."

The case of *Stewart v. Wyoming Cattle Ranche Co.*, 128 U. S. 383, 388, 32 L. Ed. 439, likewise illustrates the rule which should be here applied. There defendant owned an extensive ranch property in Wyoming, upon which he executed an option of purchase by plaintiff, a foreign corporation, at a price of $400,000. The option provided for an inspection of the premises by an agent of plaintiff's selection. Plaintiff's agent made a trip to the property, and went over it. Defendant told him that more than 2,800 head of calves had been branded within the year; that the herd consisted of approximately 15,000 head; that he did not want it generally known in the community that the ranch property was to be sold, and that the agent could rely upon his statements. The herd had, in fact, been ravaged by disease, and the number of calves surviving was substantially less than represented. The trial court instructed the jury that defendant was under no obligation to make any statements concerning the herd and the ranch property, but if he did so, it was his duty to state the full truth concerning the matters as to which he spoke, and that if plaintiff's agent was dissuaded from following up sources of information, or if defendant concealed facts within his knowledge, or led plaintiff's agent to believe that they were otherwise

than as known to defendant, then defendant was liable for fraud. This court approved the instruction, saying:

> "So the clear meaning of the sixteenth instruction is that the jury were not authorized to find material misrepresentations by the defendant, unless he purposely kept silent as to material facts which it was his duty to disclose, or by language or acts purposely misled the plaintiff's agent about the number of cattle in the herd, or the number of calves branded, or by words or silence, knowingly misled or deceived him, or knowingly permitted him to be misled or deceived in regard to such material facts, and in one of these ways purposely produced a false impression upon his mind."

The rule is also illustrated by the case of *McDonald v. DeFremery*, 142 Pac. 73, from the Supreme Court of California, and see the same case on a second appeal—*McDonald v. Roeth*, 176 Pac. 38. That case involved a charge of fraud in the sale of bank stock. Plaintiff was shown a summary of the bank's report to the Comptroller of the Currency, which contained a statement of the amounts at which the bank's loans, discounts, bonds and securities were carried on the books of the bank, but did not disclose the bad debts, suspended and over due paper, or other similar items. The full report was in the possession of the defendants, as well as a detailed audit of the affairs of the bank, which showed that its capital stock was badly impaired, because of the frozen, or uncollectible, nature of many of the loans and discounts. The trial court found for the defendants, making specific findings. The Supreme Court of California said, in reversing the judgment of the trial court:

> "If the statements and representations which were made were, in fact, false, it is immaterial that defendants believed that the bank would eventually come through its difficulties, or that the defendants did not intend to cheat the plaintiff. (Citing cases) The reliance which plaintiff was entitled to place upon this report then, was a reliance that the report was a true

statement of the bank's financial condition, and not as the court found, a mere transcript of the condition of the bank as shown by its books. Moreover, deceit may be negative as well as affirmative. It may consist in suppression of that which it is one's duty to declare, as well as by the declaration of that which is false. If it be so that defendants did not believe, and could not have believed, that the report contained a true statement of the bank's financial condition, their failure to disclose this fact to plaintiff in handing him the report forms the foundation of an action for deceit under the principle above stated."

One of the leading cases dealing with fraud in the sale of corporate securities is that of *Downey v. Finucane*, 205 N. Y. 251, 98 N. E. 391, 40 L. R. A. (N. S.) 307. Defendants there were engaged in selling securities of a corporation known as the United States Independent Telephone Company. A circular was issued which stated that the company owned a franchise in the City of New York, for the operation of a telephone system, "acquired under the advice of eminent counsel, under which it is its purpose to begin, as soon as practicable, * * * the construction of an independent telephone system." The circular also stated that $17,000,000 of bonds were to be issued pursuant to contracts already made and binding upon the company, as the result of which it would have $5,000,000 in its treasury. The evidence disclosed that the only franchise owned by the corporation was one for the operation of a burglar alarm system in the lower part of Manhattan, and that this franchise could not be converted into a telephone franchise, except by securing additional permits from public authorities, which had not been done. The only contracts entered into by the company were options given to certain of the promoters to purchase bonds, which, if exercised, would provide the company with $5,000,000 in cash. It was contended that the issuing circular contained no positively false statements, and, therefore, no actionable fraud was shown. The New York Court

of Appeals and Errors found the contention wholly without merit. That court said:

> "Speaking of an equivocal prospectus which was condemned as fraudulent by the House of Lords in *Aaron's Reef v. Twist L. R.* (1896) App. Cas. 273, 285, Lord Halsbury calls the language 'ambidextrous'; and this expression aptly characterizes that in the present case. In the case cited it was argued, as it is suggested here, that there was no specific allegation of fact which is proved to be false; but the Lord Chancellor protested against this being regarded as the true test, and declared that the question was whether taking the whole thing together was there a false representation. 'I do not care by what means it is conveyed—by what trick or device or ambiguous language. All those are expedients by which fraudulent people seem to think they can escape from the real substance of the transaction. If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false, although, if one takes each statement by itself, there may be a difficulty in showing that any specific statement is untrue.' The general reader would almost inevitably infer from this assertion in the prospectus that the United States Independent Telephone Company was a party to contracts with solvent purchasers which would enable it within a reasonable time to realize $5,000,000 in cash, and the proof shows that nothing could have been further from the truth."

We might multiply the citation of authorities establishing this sound and just rule of law, but we think the foregoing illustrate the principle which should be applied to the case at bar. Additional cases establishing the rule are cited in the Summary of Argument. It is to be noted that in the cited cases, no fiduciary relationship existed between the parties. They were merely vendors and vendees of various types of property.

Respondent, in the case at bar, was not merely silent with respect to the Lumber Company, and its guarantee. Respondent furnished to petitioner a balance sheet and finan-

cial statement of the Lumber Company as of January 1, 1930, with full knowledge that the financial condition thus disclosed had materially changed. On May 14, 1930, respondent's Chicago sales manager, Wood, wrote that petitioner had been furnished "practically all the data covering this issue of bonds." This statement was clearly calculated to lead petitioner to believe that it had received all the material information possessed by respondent as to the issue, and to persuade petitioner to forego an additional independent investigation on its own account.

After the purchase of the first block of the Longview bonds by petitioner, respondent's sales manager again wrote Hubbell representing that trunk line railroads, operating in the Pacific Northwest, might purchase the Lumber Company's railroad subsidiary. In this letter additional statements appeared which indicated respondent's belief in the financial strength of the Lumber Company, since it was retiring a large amount of its mortgage bond indebtedness.

We have then in this case, much more than mere silence upon the part of respondent, with respect to the financial condition of the Lumber Company. We have active misrepresentation, plus concealment of material facts, which brings this case squarely within the rule laid down by the authorities which we have cited. Respondent, through its sales department, by these half-truths, and by concealing the true facts, well known to its executive officers, created an essentially false impression as to the financial and credit standing of the Lumber Company. We submit, therefore, that the opinion of the Circuit Court of Appeals, holding that no actionable fraud was shown, with respect to the financial standing of the Lumber Company, is obviously wrong; that it is based upon a false premise, and a misconception of the true rule which should govern the rights of the parties.

A.

Where positive representations are made, which are true when made, but pending the transaction conditions substantially change, to the knowledge of the party making the original representations, good faith and common honesty require that the party making such representations advise the other of the change which has taken place, and failure to do so constitutes actionable fraud.

We desire to call the attention of the court to another phase of this case which was wholly ignored by the Circuit Court of Appeals. The Iowa Supreme Court in the case of *Noble v. Renner*, 177 Iowa 509, 159 N. W. 214, laid down the following rule:

> "Even if representations are true when made, and they subsequently become false by change in the subject matter, it is the duty of the person who made these representations to inform the other, and if he fails so to do, he is guilty of fraud."

This rule has always been recognized and applied in the federal courts, and is well illustrated by the opinion of the Second Circuit Court of Appeals in *Loewer v. Harris*, 57 Fed. 368, in which that court said:

> "The law requires disclosure to be made only when there is a duty to make it, and this duty is not raised by the mere circumstance that the undisclosed fact is material, and is known to the one party and not to the other, or by the additional circumstance that the party to whom it is known knows that the other party is actually in ignorance of it; but when one of the parties, pending negotiations for a contract, has held out to the other the existence of a certain state of facts material to the subject of the contract, and knows that the other is acting upon the inducement of their existence, and, while they are pending, knows that a change has occurred of which the other party is ignorant, good faith and common honesty require him to correct the mis-

> apprehension which he has created. It becomes his duty to make disclosure of the changed state of facts, because he has put the other party off his guard. The doctrine is thus stated by Mr. Pollock, in his work, Principles of Contracts, page 491: 'It is sufficient if it appears that the one party knowingly assisted in inducing the other to enter into the contract by leading him to believe that which was known to be false. Thus it is where one party has made an innocent misrepresentation, but, on discovering the error, does nothing to undeceive the other."

The record in this case abundantly discloses that if there ever was any question as to respondent's knowledge of the true financial picture of the Lumber Company at any time, respondent did have full knowledge of the demands of the commercial bankers sometime prior to June 30, 1930, for on that date Stuart wrote Long, referring to Long's "next meeting with the Chase National Bank." In the months of August and September, 1930, in reliance upon the original representations, petitioner purchased from respondent, $35,000 of the Longview improvement bonds, and in October, 1930, $202,000 of such securities.

It is conceded that Halsey, Stuart never transmitted to petitioner the fact that the Lumber Company's guarantee had become seriously impaired. The Circuit Court of Appeals for the Seventh Circuit held that there was no duty to make such disclosure. Such a rule of law is proposterous, as applied to a transaction, involving the purchase of municipal securities of a city, located two thousand miles distant from the place where the transaction is consummated. When respondent became aware, as it did sometime prior to June 30, 1930, that the Lumber Company's guarantee was of little practical value, it became its duty to communicate such fact to petitioner. It never did so. In this respect, it is also clear that the Circuit Court of Appeals for the

Seventh Circuit ignored the true rule which governs the case at bar.

IV.

The rule of caveat emptor has no application to business transactions concerning the credit and financial standing of third persons. Even where one is under no obligation to supply information as to the credit standing of a third person, if he undertakes to do so, and leads the other party to believe that the credit of such third person is different from the facts within his knowledge, and fails to disclose information vitally affecting the credit of such third person, he is liable for fraud.

The Circuit Court of Appeals, as we have already pointed out, substantially applied to this transaction, the rule of *caveat emptor*. This ancient rule, while not without proper application, has been distinctly repudiated by practically every court in the land, as applied to transactions where the parties are dealing with subject matter not readily accessible, and as to which the parties do not have equal means of knowledge. In modern times, the rule of *caveat emptor* has been distinctly repudiated as applied to representations concerning the financial or credit standing of a third party.

In *Foreman v. Dugan*, 205 Iowa 929, 218 N. W. 912, the Iowa Supreme Court recognized that the situation of the parties, the character of the property which is being dealt in, and the knowledge and means of knowledge of the parties, are material factors in the application of the rule of *caveat emptor*. In *Noble v. Renner*, 177 Iowa 509, 159 N. W. 214, the Iowa court again recognized and applied the rule.

The subject matter of the sales involved in this case was municipal improvement securities of a city located two thou-

sand miles distant from the point where the transactions were conducted. Respondent was one of the largest bond and investment houses in the country, and favorably known to petitioner. Respondent well knew that petitioner would rely upon its representations concerning these securities, and the record leaves it clear that the representations made, were deliberately made, for the purpose of inducing petitioner to purchase large blocks of the Longview improvement bonds. The situation of petitioner was, therefore, very similiar to that of one who is about to extend credit to a third person.

The rule applicable to such transactions is well stated by the text writer in 23 American Jurisprudence, Fraud and Deceit, paragraph 89, page 869, as follows:

> "Failure to disclose facts which affect the financial status or responsibility of a third person generally entails answer to inquiries or concealment of material matters upon which reliance is placed, and is frequently regarded as fraudulent in nature. Thus, concealing the condition of a person in reference to whose credit inquiries are made is a fraud, as is also the wilful suppression of material facts in regard to the credit of a third person which the inquiring party is entitled to know. Although such inquiries need not be answered, yet one undertaking to do so is not at liberty to suppress a material fact within his knowledge. The question in such a case is always whether the defendant wilfully suppressed the truth with a view of giving a third person a credit to which he was not entitled."

In *Iasigi, et al. v. Brown, et al.*, 17 Howard 183, 15 L. Ed. 208, this court had before it a case in which defendant, a banker, in response to an inquiry by plaintiff, a manufacturer, as to the credit of one Thompson, and the companies which he controlled, stated that his house had done business with Thompson for more than twenty years; that Thompson, due to the failure of another concern, had recently suffered some very serious losses, but that defendant

felt he had an abundance to pay creditors. On the strength of this letter, plaintiff sold Thompson a large amount of wool on credit. Thompson failed, and it then appeared, for the first time, that defendant held a mortgage on practically all his assets. At the close of plaintiff's evidence, the trial court directed a verdict for the defendant. This court reversed the judgment of the trial court, holding that the case should have been submitted to the jury. In the course of the opinion delivered by Mr. Justice McLean, this court said:

> "As the court instructed the jury to find for the defendant, on the ground that the plaintiffs had not sustained their action; if the plaintiffs gave, or offered to give, any evidence which was fit to be considered by the jury, the judgment must be reversed. Any evidence conducing to prove that the statements of the defendant, in the letter of the 7th of April, in regard to the condition of the Thompsonville Company and Orrin Thompson, and their ability to meet their engagements and in regard to the value of Thompson's property were false, was competent evidence as tending to prove the facts. And especially was the testimony of Grant admissible, who heard the defendant say, if the plaintiffs had called on them personally, they would not have sold their wool to the Company; also the statement that before the letter was written Brown admitted that he had lost confidence in Thompson, and therefore the letter of the 7th of April was guarded. These and all other facts which conduce to show that the defendant acted in bad faith in writing that letter, are proper to be considered by the jury.
>
> By whatever motives the defendant may have been actuated, he is not to be held responsible, unless his letters did mislead, and were intended to mislead the plaintiffs. And it will be for the jury to say, on a thorough examination of the letters, and the facts and circumstances connected with them, whether they were calculated to inspire, and did inspire, a false confidence in the pecuniary responsibility of the Thompsonville Company and Orrin Thompson. If an impression, not only of their solvency, but of their success in business,

so that by selling largely to them no more than the ordinary risks of business were incurred, was made and authorized, by the letters, while, at the same time, their true condition was known to the defendant, which did not authorize such a representation, and which was intended to deceive and mislead the plaintiffs, the defendant may be justly held responsible. But of this the jury are to judge, they being the triers of the facts outside of the letters, and which should be submitted to them for their consideration and decision."

The rule which should govern this case was expressly recognized by the Fourth Circuit Court of Appeals in *Thermoid Rubber Company v. Bank of Greenwood*, 1 Fed. (2d) 891 (C. C. A. 4th). In that case an action was instituted for damages, based on fraudulent representations as to the solvency of a concern known as the Owen Tire & Rubber Company. Plaintiff, Thermoid Rubber Company, was a manufacturer of tires and rubber goods. J. L. Self was a banker associated with the defendant, Bank of Greenwood, and was a substantial stockholder of the Owen Company, which was heavily indebted to the bank. The Owen Company sought to become the distributor of the Thermoid Company's products in a large territory, and desired to purchase large quantities of tires and rubber goods on credit. Some shipments of goods were made by the Thermoid Company, and having some question as to the financial situation of the Owen Company, it addressed a letter of inquiry to the bank. An officer of the bank replied that the Owen Company's loans with the bank had recently been very substantially reduced; that the company had always met its obligations with the trade, and that the bank considered the company in good shape. These fact statements were true, but the bank officers knew that Self had personally taken up a number of the Owen Company's loans, and had kept it afloat as a going concern. Thermoid Company extended large credits to the Owen Company, which shortly went in-

to receivership. The trial court submitted the case to the jury, under instructions stating that if the Thermoid Company had extended credit to the Owen Company before the bank letter was written, no recovery could be had. The Fourth Circuit Court of Appeals reversed the judgment, saying:

> "One may deceive, though he says nothing which is itself untrue. The telling of but part of the truth may sometimes effectually mislead. If A, in answering a question of B's, chooses what he shall say and what he shall keep to himself, with a purpose of leading B to a wrong conclusion, he is morally a deceiver. If B understands the fact to be as A has intended he should, A may be legally liable as well. In order that he shall be, it is necessary that B shall have acted upon the conclusion to his hurt, as the learned court below correctly told the jury."

These authorities, we submit, announce the rule which the Circuit Court of Appeals should have applied to the case at bar. It was respondent's duty in making statements concerning the financial standing of the Lumber Company, to make a reasonably full disclosure of the true facts. Respondent could not, without incurring responsibility for fraud, indulge in half-truths, and misleading statements as to the true facts. It was not at liberty to furnish the favorable facts concerning the financial position of the Lumber Company, and suppress facts which, if disclosed, would have made it plain that the Lumber Company's guarantee was of extremely doubtful value. The decision of the Circuit Court of Appeals for the Seventh Circuit is quite obviously founded upon a misconception of the true rule of law which should be applied.

V.

The conclusion of the Appeals Court, that the letter of May 14, 1930, stating

> "We believe you have before you practically all the data covering this issue of bonds," and
>
> "You observe, of course, that this city has no funded debt other than these improvement bonds,"

was of "trivial materiality," substitutes the judgment of the Circuit Court of Appeals for that of the jury, on the weight of the evidence.

Petitioner expressly pleaded as a specification of fraud, the recitals of the Wood letter of May 14, 1930, set forth above, charging that this was a false representation that the Longview local improvement bonds were the only outstanding bonds which were liens, or charges, upon Longview real estate. In its answer respondent expressly admitted that it well knew that the diking district bonds were outstanding, and that the assessments for payment of those bonds were liens upon substantially every lot and parcel of land within the city. Of course, respondent well knew of the existence of the diking bond issue, for it had purchased the entire issue from the Lumber Company in 1925, and resold the same.

The Circuit Court of Appeals for the Seventh Circuit, in its opinion, characterized the Wood letter as

> "A careless statement for a representative of respondent to make, implying, as it did, that the bonds involved were part of the funded debt, and that there were no other obligations on the part of the city which were equal or superior to them." (R. 667)

The opinion of the Appeals Court then goes on to dispose of this charge of fraud in the following words:

"However, Hubbell admitted that he knew that the bonds did not constitute a funded debt, and he also admitted that he had read a paragraph in the Long-Bell balance sheet referring to the accrued assessments on Diking and Improvement District bonds guaranteed by Long-Bell, and to the fact that the former were issued to take up warrants issued in payment for construction work, and that he knew that there was a consolidated diking district, but he had never thought to ask where the diking system was located. He also admitted that until after 1932 or 1933 he had never investigated the possibility of overlapping municipal districts. In view of all these facts, we are of the opinion that the materiality of the letter and its possible implications is trivial."

Were the statements and implications of the Wood letter of "trivial materiality," and did the Seventh Circuit Court of Appeals properly so declare? First, it must be noted that Frank Wood, the writer of the letter, was the sales manager of Halsey, Stuart, in the territory embracing the State of Iowa. Hubbell had known Wood for several years. He knew him as a responsible officer of Halsey, Stuart & Co. Over Wood's personal signature, in this letter Hubbell was told that he had already been furnished "practically all the data covering the issue," and that Longview had no funded debt, "other than these improvement bonds."

It is clear that these statements were expressly made to induce the purchase of the bonds by petitioner. Would not any well-informed purchaser of bonds understand from the plain recitals of this letter, that he had received all the material facts which he needed, in order to form a considered judgment as to the value of the bonds? Would not any well informed purchaser of securities understand that the Longview improvement bond issue constituted the only outstanding issue of assessment securities in the City of Longview?

Hubbell had already been told that more than one-third of the local improvement bonds originally issued, had been retired, and that only about $2,000,000 remained outstanding. Had these been the only special assessment liens upon the Longview property, it is apparent that the value of the improvement bonds, as investments, would have been materially enhanced. The fact that $2,554,000 of diking district bonds were then outstanding, and were secured by superior liens upon the very properties, which constituted the sole tangible security for the local improvement issues, was certainly a very material factor in the value of the local improvement bonds for investment purposes.

Respondent was not merely silent with respect to the existence of the diking district bonds and assessments. There was a direct, positive representation that the city had no funded debt, "other than these bonds." Of course, special assessment securities do not constitute general obligation bonds of a municipality, and as such, are no part of its funded debt, and Hubbell so understood. But, by the use of the words, "other than these bonds," respondent led Hubbell to believe that these securities were the only ones of the same general type, outstanding in the municipality. Had the statement merely been that the City of Longview "has no funded debt," it would have been true, but the statement that the city had no funded debt "other than these bonds," was extremely misleading, and constituted a false representation, in view of respondent's knowledge of the character and amount of outstanding diking bonds.

We are unable to understand how the Circuit Court of Appeals for the Seventh Circuit arrived at the conclusion that the statements of the Wood letter of May 14, 1930, were rendered of "trivial materiality" by Hubbell's statement, on cross examination, that in 1930, it was not his general custom in buying, for example, a water works bond

in a particular city, to investigate and ascertain how many city bonds, school district, or county bonds were outstanding in the same territory. Here Hubbell was directly told that there were only $2,000,000 of special assessment securities outstanding in this city of 12,000 population. If this was a false and misleading representation, respondent's liability therefor is not affected by the custom or practice which Hubbell, as a bond purchaser, customarily followed. We shall point out in another division of this brief that contributory negligence on the part of Hubbell, or petitioner, is no defense to a charge of fraud, although the Seventh Circuit Court of Appeals apparently assumed otherwise in deciding the case.

In determining that "the materiality of the letter (of May 14, 1930) and its possible implications is trivial," the Seventh Circuit Court of Appeals was apparently influenced by the same misconception as to the rules of law which govern the rights of the parties as appeared in the opinion with respect to other charges of fraud. Apparently that court regarded the statements of the Wood letter as nothing more than a failure to disclose the existence of the diking district bonds. But, Halsey, Stuart was not merely silent with respect to the existence of those bonds. The language of the Wood letter was a direct representation that there were no other bonds of similar character outstanding, and brings the case squarely within the rule that a seller of securities may not, by misleading statements, induce in the mind of a prospective purchaser an understanding of facts and conditions vastly different from those known to exist, and escape liability for misrepresentation. Had Halsey, Stuart & Co. said nothing whatever as to the existence of other securities at Longview, perhaps there would have been no fraud. Had Halsey, Stuart merely said that the City of Longview had no funded debt, such statement would have been true. The language of the Wood

letter constituted a representation that the improvement bonds were the only ones outstanding, and brings the case squarely within the rule of law cited under Division III of this brief.

Hubbell testified positively that he relied upon the Wood letter. We have already pointed out that it was natural for him to do so, because of Wood's position with respondent, and Hubbell's previous acquaintance with him. We have always understood that the weight of the evidence, and the inferences to be drawn therefrom, are questions for submission to and determination by a jury, and that no court has any right to substitute its own judgment upon conflicting facts, for that of the jury. Of course, the Wood letter was a written instrument, and it was the duty of the court to construe it in the light of the circumstances surrounding the parties. The Circuit Court of Appeals could only arrive at the conclusion which it did, by ignoring well established rules of law pertaining to known false and misleading statements.

VI.

That petitioner might have learned the true facts with respect to the location of the industrial mill properties at Longview, by independent investigation, or could have learned of the trend of the Lumber Company's earnings from other sources, constitutes no defense to charges of fraud. The Iowa law (which governs this case) is that mere negligence of a defrauded vendee can never be pleaded as a defense to a charge of fraud.

Throughout the opinion of the court below there appears, at various times, the thought that petitioner failed to adequately protect itself against the consequences of respondent's misrepresentations, by investigation on its own account. For instance, it is stated at R. 664, that during

May, 1930, "it became publicly known that Long-Bell had sustained substantial operating losses since the beginning of the year." The opinion points out that petitioner was a subscriber to the "Chicago Journal of Commerce," and "The Analyst," which, in their respective issues of May 20 and May 23, 1930, carried reports that the Lumber Company had sustained an operating loss of $300,000 for the three months ending March 31, 1930. At R. 668, the Appeals Court, in speaking of the January 1, 1930 financial report and balance sheet of the Lumber Company, states:

> "Moreover, that report contained within its own four corners what might well have served as notice of financial difficulties of the company—we refer to a paragraph in the letter to stockholders dated March 12, 1930, which accompanied the balance sheet, stating that general conditions following the stock market break had seriously affected the consumption of lumber which was seriously reflected in Long Bell business, and that what the last two quarters of the year would be, depended upon crops and general business conditions. It is inferable that if appellant had been very anxious to conceal the condition of Long Bell it might well have removed this letter from the accompanying statement, calculated as it was to raise questions as to the then position of the company."

On the same page the court points out that

> "Had appellee made use of the financial news reports available in its own offices it would have learned of this fact long before the subsequent purchases were made. Not only did it not make any use of these sources of information, but it did not even inquire of appellant as to whether or not the situation had changed in any way."

At R. 671 the court points out that the literature submitted to Hubbell disclosed that the establishment of Longview as a city by the Long-Bell Lumber Company was a very grandiose scheme, and that

"It seems to us that any really thoughtful consideration on the part of the appellee would have suggested it, and would have suggested more pertinent questions, such as the success of the development, the population in 1930, the valuation of the benefited properties, and the amount of the unsold land. It appears that when appellee did become suspicious and made inquiries concerning the city, it was able to find out the facts at once, and there is nothing to suggest why it could not have found them with equal facility before it purchased the bonds."

These excerpts from the opinion of the Circuit Court of Appeals make it plain that that court was very largely influenced in arriving at the decision which it did, by the thought that petitioner did not use adequate care to protect itself against the consequences of respondent's conduct. We are unable to understand the statements of the opinion upon any other hypothesis.

Of course, it must be borne in mind, that the parties were dealing in the special assessment securities of a municipality located two thousand miles distant from Des Moines, Iowa, where the negotiations were conducted and the transaction consummated. It must be borne in mind that the only information which petitioner could have gained by an examination of the financial news services was that the Lumber Company had sustained certain operating losses in the early months of 1930. These financial news services did not disclose the fact that the Lumber Company had under contemplation the formation of a new subsidiary, to which all of its liquid and unencumbered assets would be conveyed. Such information was known only to the officers of the Lumber Company, its commercial bankers, and certain "insiders" like respondent.

Here again it is apparent that the Circuit Court of Appeals has wholly misconstrued and misapplied the rules of law which govern the rights of the parties. It is the rule

in Iowa, and in most other jurisdictions, that failure of a purchaser of securities to conduct an investigation on his own account, constitutes no defense to a charge of fraud in connection with the sale of such property. It is well established by the decisions of the Iowa Supreme Court, that the fact that one may not have acted with reasonable prudence, will not defeat recovery where he relies upon the representations of a seller. The Iowa Supreme Court has time and again laid down this wholesome rule, and it was utterly ignored by the Seventh Circuit Court of Appeals in its decision.

In *Ford v. Ott*, 186 Iowa 820, 173 N. W. 121, at page 828, the Iowa Supreme Court states the rule in these words:

> "A person guilty of fraud may not be heard to urge that his victim ought to have found him out in time to have prevented the wrongdoer from perpetrating the wrong undertaken."

In *Creamer v. Stevens*, 192 Iowa 920, 185 N. W. 581, which involved an exchange of Dakota lands for Texas lands, the trial court directed a verdict for the defendant at the close of plaintiff's evidence. The judgment was reversed by the Iowa Supreme Court, which said:

> "It is contended by appellant that, if plaintiff relied upon the statements of defendant, and was defrauded thereby, he is entitled to relief, even though he failed to resort to the means available for the detection of the falsity of the statements; and that he is entitled to relief even though he made some examination of the land in question. Many of the cases before cited are cited on this proposition. In one of the last cases, *Christensen v. Jauron, supra*, the court instructed the jury that if, upon inspection of the land, plaintiffs ascertained the falsity of the representations, if made, or might have done so by the exercise of ordinary diligence, they might not recover. We there said, as we have said in other cases, that the law is not thus tender of persons practicing deceit; that, if plain-

tiffs did ascertain the actual condition of the land, they could not have relied on the representations. But the victim was not required to exercise diligence to ascertain whether the wrongdoer has lied to him, as a condition precedent to recovery of the damages suffered in consequence of the deception. *Hise v. Thomas, supra; Holmes v. Rivers,* 143 Iowa 702; *Hetland v. Bilstad, supra.* In the *Holmes* case, we said:

> 'A seller who has successfully entrapped his victim with false statements of the kind mentioned will not be permitted to escape when called upon to account in a court of justice, on the ground that his dupe did not, but ought to have, suspected him to be a knave.' "

In *Gardner v. Trenary,* 65 Iowa 646, 22 N. W. 912, plaintiff conveyed a house and lot to the defendant in exchange for an exclusive license to sell a patented article in a particular territory. The patent covered a contrivance designed to be attached to a walking plow. The invention could not be made to work as defendant claimed, and represented. Plaintiff saw the patented article, and it was urged that had he made an adequate inspection and investigation of it, he could have readily ascertained the true facts, and hence could not complain of the defendant's fraud. The Iowa Supreme Court disposed of this contention in these words:

> "But the law will not allow one committing a fraud of this kind to protect himself by the claim that his victim was easily deceived and did not act in the matter with reasonable prudence." (65 Iowa, 648)

These authorities from the Supreme Court of Iowa make it plain that petitioner was under no such burden of investigation, as the opinion of the Circuit Court of Appeals imposed upon it. The subject matter of the sale involved in this case was not tangible personal property, which was at hand, and open to inspection. The parties were dealing

in special assessment bonds of a municipality. These bonds supposedly had been investigated by respondent, and approved as meeting respondent's requirements for a desirable investment security. The City of Longview was more than two thousand miles distant from Des Moines, Iowa, where the transaction took place. Petitioner was not told that the improvement bonds were of little or no value, based upon their real estate security, and that respondent had purchased them solely because they bore the guarantee of the Long-Bell Lumber Company. Neither was respondent informed that the Long-Bell Lumber Company was in a precarious financial condition, and that its commercial bank creditors were demanding that the company be dismembered, and all of its liquid and unencumbered assets be transferred to a new corporation, for the purpose of placing commercial bank creditors in preferred position.

The Circuit Court of Appeals for the Seventh Circuit apparently considered petitioner's failure to conduct an independent investigation, as of controlling importance. Such fact was utterly immaterial under the rule of law which has long obtained in Iowa, as we have already pointed out. Contributory negligence on the part of a defrauded purchaser is no defense to a charge of this character, and the Seventh Circuit Court of Appeals erred in holding that petitioner's conduct in not conducting an investigation on its own account barred its right of recovery.

CONCLUSION.

We have pointed out in the preceding portions of this brief that the decision of the Seventh Circuit Court of Appeals was predicated upon wholly untenable grounds. For the most part, the opinion of that court correctly states the facts disclosed by the record. The court below, however, incorrectly stated at R. 672 that

"The record does not indicate that appellant (Halsey, Stuart) had any more knowledge than appellee that this vacant, unimproved land, still belonging to Long-Bell, amounted to from sixty to seventy-five per cent of the total. Certainly, there is nothing of record to indicate that appellant deliberately withheld information as to this from appellee."

The court below overlooked some very vital testimony, for the record shows that respondent had in its possession Exhibit "P-50," the 1927 year end sales report of the Longview Company to Mr. R. A. Long. That document shows that less than half of the platted lots included within the City of Longview had been sold as of December 31, 1927, and it must be borne in mind that only approximately one-third of the land, embraced within the limits of the City of Longview, was ever platted. (See R. 214) It is conceded that real estate sales, after 1927, at Longview, substantially ceased. (R. 215)

Respondent likewise had in its file Exhibit "P-51," a similar report covering the activities of the Longview Company real estate sales department for the month of May, 1928, and Exhibit "B-18," a similar report for the month of April, 1928. These exhibits, all of which were produced from the files of respondent, make it plain that respondent was fully aware of the situation which existed, and well knew that the efforts of the Lumber Company to rapidly market the Longview real estate had proved a failure, and in May, 1930, when the bonds were offered to petitioner, respondent well knew the facts.

We have then this situation: In 1925, 1926, and 1927, respondent purchased from the Lumber Company the various issues of the Longview local improvement district bonds. It knew at that time that the bonds were without substantial value, except as the guarantee of the Long-Bell Lumber Company insured their payment at maturity. By May 1, 1930, respondent well knew that the grandiose

scheme of urban development which the Lumber Company had sponsored, had proved a disastrous failure. By that time it knew that the Lumber Company had fallen upon disastrous times, and that the guarantee of the Lumber Company was of no substantial value. Respondent well knew, in other words, that the Longview local improvement bonds were well-nigh worthless, because neither the real estate assessments, nor the guarantee of the Lumber Company, were sufficiently strong to indicate more than a remote possibility of repayment. No one can read this record and say that a jury could not conclude that this was the true state of affairs. In fact, we believe that the undisputed evidence affirmatively establishes the facts as we have outlined them.

It was under these circumstances that respondent, first delivered to petitioner the offering circular, Exhibit "B-1," and later the other exhibits which contained such glowing accounts of the commercial prospects of the City of Longview as a great industrial center, and in which the representations were positively made that the vast properties of the Long-Bell Lumber Company, Weyerhaeuser Timber Company, Longview Fiber Company, and others, were within the City of Longview. No one can read this record and conclude that the officers of respondent actually believed that these vast industrial properties were subject to assessment in any of the Longview local improvement districts, and the evidence was such as to make the question of respondent's knowledge of the true location of the industrial properties a question for the jury. In any event, respondent had no right to make reckless statements concerning the location of these industrial properties to induce petitioner to invest its policy reserves in such securities. The record shows that respondent's conduct was reckless in the extreme, if it in fact had no knowledge concerning the true location of the mill properties.

It is equally plain that the assuring letter written by Wood, respondent's Chicago sales manager on May 14, 1930, contained positive representations which led petitioner to believe that the Longview local improvement district bonds were the only outstanding securities in the territory, and that nothing could have been further from the truth. It is also established that respondent well knew the true situation with respect to the Long-Bell guarantee, and with such knowledge, indulged in half-truths and created in the minds of petitioner's officers a wholly false impression as to the strength of the Lumber Company's guarantee. These facts, most of which are wholly undisputed, clearly establish that the question of respondent's liability for false and fraudulent representations concerning the Longview local improvement district bonds presented an issue for determination by a jury. The Circuit Court of Appeals erroneously applied to the facts of this case the ancient doctrine of *caveat emptor*. It erroneously determined that the so-called "hedge clause" of the offering circular afforded a legal defense to respondent for its misrepresentations concerning the location of the mill properties and the frontage of the City of Longview upon the Columbia River. That court clearly invaded the province of the jury in determining that the statements of the Wood letter of May 14, 1930, were of "trivial materiality."

The conduct of respondent in this transaction is such that it should shock the conscience of any court. The Circuit Court of Appeals ruled that petitioner was without remedy under the circumstances disclosed by this record. If this be true, it is, indeed, a severe indictment of our judicial system, and of the rules of law which govern the rights of the parties. We do not believe that the decision of the Circuit Court of Appeals can be upheld, and we respectfully submit that the decision of that court was based

on untenable grounds, and that the same should be reversed by this court.

Respectfully submitted,

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